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Securing Creditor Interests in Federal Farm Program Payments

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SECURING CREDITOR INTERESTS IN FEDERAL FARM PROGRAM PAYMENTS

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INTRODUCTION—THE ROLE OF FEDERAL FARM PROGRAM PAYMENTS

In 1986, the federal government made payments of over $25 billion to United States agricultural producers through agricultural price and income support programs.[1] These federal farm program payments were the result of a variety of differing agricultural programs, including commodity price support loans, target price deficiency payments (a form of direct income subsidy), land diversion or set-aside payments, commodity storage agreements, soil and water conservation programs and other various commodity programs.[2] The purpose of the federal farm programs, derived from a combination of national policy established by Congress in the quadrennial farm bill[3] and the annual program modifications made by the United States Department of Agriculture (USDA),[4] are designed to establish the economic environment in which agri-

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1. Government spending on farm price and income support programs during fiscal 1986 was $25.8 billion and for fiscal 1987, such spending was projected at $25.3 billion. The payments include over $12 billion of direct cash payments and over $13 billion in nonrecourse price support loans. ECON. RESEARCH SERVICE, U.S. DEP'T OF AGRIC., *The Outlook for Farm Program Spending*, AGRIC. OUTLOOK 24 (Apr. 1987).

2. Present programs are implemented under the authority of the AGRICULTURAL ACT OF 1949, 7 U.S.C. § 1421 *et seq.* (1982), *as amended* by the FOOD SECURITY ACT OF 1985, PUB. L. NO. 99-1998, 99 Stat. 1354 (1985); 7 U.S.C. § 1281 (Supp. IV 1986). Congress has authorized the USDA to implement the various federal farm programs. *See* the AGRICULTURAL ACT OF 1949, 7 U.S.C. §§ 1421-1449 (1982), *as amended by* the SOIL CONSERVATION AND DOMESTIC ALLOTMENT ACT, 16 U.S.C. §§ 590a-590g (1982). The programs are administered by the Agricultural Stabilization and Conservation Service (ASCS) as authorized by 16 U.S.C. § 590h(b) (1982) and the Commodity Credit Corporation (CCC) as authorized by 62 Stat. 1070 (1948), codified at 15 U.S.C. § 714 (1982).

A recent case illustrates the variety of farm programs in which a farmer may participate and the differing types of payments that he may receive. In *In re Sumner*, 69 Bankr. 758 (Bankr. D. Or. 1986), the federal farm payments at issue in the bankruptcy proceeding included the following varied amounts: $40,991 of crop proceeds; $3,703 in crop storage payments; $600 diversion payment; $12,000 in deficiency payments; $15,000 in soil conservation cost-sharing payments; and over $24,700 in conservation reserve program payments.

3. The most recently enacted farm bill is the FOOD SECURITY ACT OF 1985, PUB. L. NO. 99-198 (1985). For a discussion of the historic operation of the "Farm Bill," *see* Harkin & Harkin, *"Roosevelt to Reagan" Commodity Programs and the Agriculture and Food Act of 1981*, 31 DRAKE L. REV. 499 (1981-82); W. RASMUSSEN & G. BAKER, PRICE SUPPORT AND ADJUSTMENT PROGRAMS FROM 1933 THROUGH 1978: A SHORT HISTORY (Econ., Statistics and Cooperative Service, U.S. Dep't of Agric., Agric. Information Bull. No. 424, 1979).

For a general discussion of the operation of federal farm programs, *see* Fraas, *Federal Assistance Programs for Farmers: An Outline for Lawyers*, 1981-82 AGRIC. L.J. 405; Hamilton *Farmers' Rights to Appeal ASCS Decisions Denying Farm Program Benefits*, 29 S.D.L. REV. 282 (1984).

4. The rules for administering the various federal farm programs are found at 7 C.F.R. Part 713 (1987) and other related sections. When the Secretary of Agriculture determines the specifications for each year's farm programs, new regulations are promulgated as necessary. Final regulations were published on Thursday, October 16, 1987 at 51 Fed. Reg. 36902 (1987). Earlier versions of these

culture functions. As such, federal farm programs and policies have a direct effect on the financial health of the agricultural sector and to an extent on the demand for agricultural credit. The level of federal farm program payments has increased dramatically in recent years as changes in federal agricultural price and income policy have resulted in a substantial portion of agricultural income coming from the government rather than the market place.[5] The growing significance of federal farm program payments as both a source of income and alternative financing within agriculture[6] make understanding the interplay between Article 9 of the Uniform Commercial Code (U.C.C.) and such payments a crucial topic for parties engaged in agricultural finance.

The primary Article 9 related issue concerning federal farm program payments is the ability of an agricultural producer's secured creditor to establish a claim to such payments under the U.C.C. and the proper classification of such payments for creditor disputes.[7] This is a very significant issue due to the magnitude of the payments and to their status as "new money" flowing into the operation. In fact, in a debt enforcement or liquidation setting, the federal payments are often the major or only form of money left for creditors to dispute over. As a result, literally dozens of courts have recently considered these issues.[8] The number and frequency of disputes will surely grow.

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regulations are at 51 Fed. Reg. 8428 (1986) (Implementation of the FOOD SECURITY ACT OF 1985); 51 Fed. Reg. 21828 (1986) (Interim Rule); 51 Fed. Reg. 28921 (1986) (Interim Rule).

5. In 1980, direct government cash payments under federal farm programs were $1.3 billion. By 1986, direct government payments had risen to over $12 billion ($8 billion in cash and $4 billion in commodity certificates). Direct cash expenditures for 1987 were projected to be between $14 billion and $16 billion (one-half cash and one-half payment in kind (PIK)). ECON. RESEARCH SERVICE, U.S. DEP'T OF AGRIC., AGRIC. OUTLOOK 61, Table 32 (Aug. 1987).

6. Price support loans, in addition to helping establish a price floor for program crops, are also a significant form of short term financing. A farmer can place his or her grain under loan after harvest and use the loan proceeds to finance the making of next year's crops, rather than having to sell the harvest to finance the new crop. This not only provides flexibility in marketing, but also short term financing. In 1980, U.S. farmers had $5 billion in outstanding price support loans with the Commodity Credit Corporation (CCC). In 1986, the figure had grown to over $20 billion. *Id.* at Table 33.

The importance of federal price support programs to the South Dakota economy is apparent from the level of participation in such programs. The United States Bankruptcy Court in South Dakota provided insight into the level of participation in a recent case:

> According to the United States Department of Agriculture (ASCS) statistics, in fiscal year 1987-88, 41,562 of 52,274 South Dakota farms participated in the various ASCS-CCC farm subsidy programs (approximately 80 percent). The breakdown in terms of acreage is as follows: of 4,820,988 wheat acres, 4,439,046 are enrolled; of 3,869,322 corn acres, 3,495,630 are enrolled; of 546,777 grain sorghum acres, 468,475 are enrolled; of 831,458 barley acres, 657,230 are enrolled; and of 1,970,022 oats acres, 1,223,627 are enrolled. While the percentage breakdown of how many South Dakota debtor-farmers are participating is unknown, the Court has no reason to believe that it would differ from the general farmer population.

In re Rinehart, 76 Bankr. 746, 754 n.13 (Bankr. D.S.D. 1987).

7. For a thorough and reasoned discussion of the theoretical relationship between the operation of the U.C.C. and the purpose of federal farm programs, *see* Rasor & Wadley, *The Secured Farm Creditor's Interest in Federal Price Supports: Policies and Priorities*, 73 KY. L.J. 595 (1985).

8. The various cases, which are discussed in this section have been the subject of a number of law review articles, including the following: Deaner, *Protecting a Lender's Security Interest in PIK Collateral*, 5 J. AGRIC. TAX'N & L. 107 (1983); Marsh, *Are PIK Payments "Proceeds" Under Article 9?*, 7 J. AGRIC. TAX'N & L. 291 (1986); Comment, *Bankruptcy, the U.C.C., and the Farmer: PIK Payments—Heads "General Intangibles," Tails "Proceeds"*, 26 WASHBURN L.J. 178 (1986). For a general discussion of these issues, *see* Schneider, Hayes & Kunkel, *Security Interests in Payments from Government Farm Programs*, AGRIC. L. UPDATE 4 (Apr. 1987); Rasor & Wadley, *supra* note 7.

In addition to the basic issue of the availability of federal farm payments as a form of securable collateral, there are important issues concerning the use of the federal assignment procedure, the application of bankruptcy rules to post-petition property, and federal authority for administrative offset. A related question is the potential for federal preemption of state law concerning creditor claims as applied to certain forms of farm payments. All of these issues are considered in this article.

THE NATURE OF FARM PROGRAM PAYMENTS AND THE FORM OF PAYMENT

In 1983, the USDA created the payment-in-kind (PIK) program. Under PIK, producers who either retired crop ground from production or who plowed under already planted crops received entitlements to redeem specific amounts of commodities held at designated warehouses or their own grain which was under loan.[9] The question of the legal nature of PIK benefits caused much confusion and resulted in considerable litigation. The cases generally dealt with the classification of such benefits for purposes of creditor security interests, particularly whether they were some other form of collateral, such as general intangibles or accounts.[10]

For 1986 and future farm programs, the USDA has developed the concept of a generic commodity certificate, which represents the right to receive a specific dollar amount of any surplus government commodity, the exact amount to be determined on the basis of the commodity price the day the certificate is redeemed by the producer.[11] One goal of the USDA in implementing the generic commodity certificate program was to facilitate the 1985 farm bill policy of lowering domestic commodity prices to enhance export sales. This was possible by allowing farmers to use PIK certificates to redeem grain under loan that would have been otherwise locked off the market for the period of the loan, thereby converting the grain into free stocks. The generic PIK certificate was also designed to create a secondary market for such certificates and has led to the certificates being negotiated as a form of script—a substitute for direct cash payments. Farmers quickly discovered the many marketing options made possible with such certificates and, by the fall of 1986, certificates were selling for over twenty percent above face value in Iowa.[12]

9. For a contemporary discussion of the PIK program, *see* Deaner, *supra* note 8.

10. For a good discussion of these cases, *see* Comment, *supra* note 8.

11. *See* 7 C.F.R. § 770.4(g) (1987); 51 Fed. Reg. 36902 (1986).

12. For a discussion of the operation and economic significance of the generic PIK program, *see* ECON. RESEARCH SERVICE, U.S. DEP'T OF AGRIC., *Generic Certificates Help Meet Goals of 1985 Farm Act*, AGRIC. OUTLOOK, 16-24 (Apr. 1987).

The PIK certificates can be used for the following purposes:

1. Cash sales to private individuals or firms;
2. Redemption for cash at ASCS (after first transfer deadline);
3. Redemption of CCC loans to stop or avoid storage cost;
4. Redemption of CCC loans to obtain benefits of loan program when storage space is not available;
5. Redemption of CCC loans to take advantage of potential storage returns from cash market, contracting or hedging;

The existence and use of generic PIK certificates to make farm program payments is significant for a number of reasons. First, the magnitude of certificates issued is substantial. The projected value of 1987 certificates exceeds $7 billion, clearly making the certificates an important form of collateral. Second, the current nature of the generic certificate program creates the potential for confusion, especially when considering cases that dealt with 1983 PIK payments—the "PIK as proceeds" issue. Third, USDA rules concerning the nature of generic certificates and the possibility of creditor claims to the certificates creates the potential for substantial confusion when dealing with creditor claims to farm program payments.

Under the present farm programs, producer benefits may be paid in cash, in generic PIK certificates, or, in most instances, in a combination of both.[13] Additionally, PIK certificates are no longer used solely for land diversion as they were in 1983. Instead, the certificates may be received for any type of federal farm program benefit, including deficiency payments. As a result, while the form of a payment may be a consideration in determining its legal treatment, the nature of the program and activity for which the payment was received are generally more significant.[14]

Classifying federal farm programs for security interest purposes involves considering the nature of the payments under the programs. For example, target price deficiency payments and disaster payments are a form of income subsidy. The amount of the deficiency payment a producer receives is a function of the producer's eligible crop base and average yield for that commodity. Disaster payments are a function of damaged crops. Both payments, however, are considered to be the proceeds of a crop. The two earliest cases dealing with legal treatment of farm program payments for security reasons, *In re Munger*[15] and *In re Nivens*,[16] concluded that such payments were cash proceeds perfected by the financier's filing as to crops under U.C.C. § 9-306(3)(b). Receipt of the payments represented a "disposition" of the crops within the meaning of § 9-306 and the payments were thus proceeds.

Contrast those payments with land diversion or retirement payments which are calculated on the basis of the number of eligible acres that a producer agrees to remove from production. While the courts have been sharply divided on whether to classify such payments as proceeds or as something else, such as general intangibles, the most correct legal answer would appear to be

6. To enhance returns from reserves rotation by sealing and redeeming replacement grains before using it to replace rotated stocks;
7. To permit early redemption and sale of sealed grain before it goes out of condition;
8. To obtain benefits of CCC loan programs while feeding the grain to livestock; and
9. Enhancing the price of forward-priced grain sold for fall or winter delivery.

13. *See* CCC-477 Appendix, Paragraph 8, Contract to Participate in the 1987 Price Support and Production Adjustment Programs; 7 C.F.R. Part 770, Commodity Certificates, In Kind Payments, and Other Forms of Payment (1987).

14. *See* In re Harding, 69 Bankr. 681 (Bankr. N.D. Tex. 1987) (1986 generic PIK certificate payments received as deficiency payments are a substitute for the crops).

15. 495 F.2d 511 (9th Cir. 1974) (Payments under the SUGAR ACT are proceeds).

16. 22 Bankr. 287 (Bankr. N.D. Tex. 1982). *See also* In re Kruger, 68 Bankr. 43 (Bankr. C.D. Ill. 1986).

that payments received for agreeing not to raise a crop cannot be considered the "proceeds" or substitute of a crop which was never grown.[17]

Farm program benefits may also be received for other purposes. Farmers and warehousemen may store grain under the farmer-owned reserve program. The stored grain is used as collateral for a government loan. The farmers and warehousemen receive storage payments which are essentially earned for rendering a service to the government.[18] Farmers who participate in the long-term conservation reserve program receive annual land rental payments, a form of diversion payment, as well as federal cost-sharing money to cover one-half the cost of establishing necessary conservation practices.[19] Under the National Wool Act, sheep producers receive incentive payments which have been held to be "products" of the sheep.[20] Another form of farm payment was received by dairy producers who participated in the Dairy Herd Termination (DHT) program, thereby agreeing to slaughter or export their dairy herds and to refrain from operating a dairy for at least five years. Such payments are not "proceeds" of a farmer's dairy cattle because a portion of the payment is essentially for the purpose of the farmer's keeping his or her expertise in dairy production off the market for the contract period.[21]

As these cases indicate, consideration of the nature of the programs under which payments are received can be of great assistance in accurately classifying the type of collateral the payments represent. Just as one type of farm program payment should not be capable of being simultaneously classified as several different types of collateral, different types of farm payments may not all be the same type of collateral. While many recent cases do not directly focus on this consideration, the increasing economic importance of federal payments and a refined legal understanding of the programs suggest that a creditor's wisest approach to securing and preserving an interest in federal farm payments is based on a knowledge and recognition of the nature and function of the particular type of payment.

CASES CONCERNING THE CLASSIFICATION OF FEDERAL FARM PROGRAM PAYMENTS

The majority of cases involving farm program payment issues have focused on the question of classification for purposes of determining the priority of legality or creditor claims to such payments. In the last five years, over three dozen federal courts have been asked to resolve disputed claims to federal farm program payments. The cases, which primarily arose in the context

17. Marsh, *supra* note 8. *See, e.g.*, Matter of Schmaling, 783 F.2d 680, 683 (7th Cir. 1986).

18. *See* In re Connelly, 41 Bankr. 217 (Bankr. D. Minn. 1984) (storage payments under a grain reserve program are not proceeds of the crops). *Accord* In re Sumner, 69 Bankr. 758 (Bankr. D. Or. 1986).

19. *See* CRP-1, Conservation Reserve Program Contract; 7 C.F.R. Part 704, Conservation Reserve Program (1987). *See infra* discussion in section X.

20. *See* In re Patsantaras Land and Livestock Co., 60 Bankr. 24 (Bankr. D. Colo. 1986); In re Mahleres, 53 Bankr. 86 (Bankr. D. Colo. 1985).

21. Grunzke v. Security State Bank of Wells, 68 Bankr. 446 (Bankr. D. Minn. 1987).

of a farm bankruptcy proceeding, have dealt almost exclusively with three of the many federal farm programs, namely, the 1983 payment-in-kind (PIK) program, the 1985 milk diversion program and the 1986 Dairy Herd Termination (DHT) program.

The issues raised and the questions addressed by the courts typically follow the same pattern which facilitates a discussion and classification of the cases. The first question is generally as follows: Does the creditor have a valid claim to the debtor's farm program benefits under the terms of the security agreement? To answer this question, the courts must identify the types of collateral claimed in the security agreement, and then analyze how the payments in question must be classified. The cases fall into two main schools of thought: (1) the payments are either "proceeds" of the crop (or other farm collateral), or (2) the payments are not proceeds, but are some other form of collateral, such as "general intangibles," "accounts" or "contract rights."

If the court determines the creditor's claim is not valid, the inquiry usually stops. If the creditor's claim is upheld, however, many courts go on to consider a second question: Is there some other reason why the claim is not valid or is unenforceable? In this context, the cases generally focus on claims that the failure to use the federal procedure for assignment of benefits prevents other claims or that the payments are post-petition property under § 552(a) of the Bankruptcy Code and thus not reachable by the creditor.

Farm Program Payments as Proceeds

One major branch of farm program cases has involved claims that federal farm payments were covered by existing security agreements, in particular, the "proceeds" language of such agreements. Bankruptcy courts in four states and high state courts in two others have ruled that 1983 PIK payments and milk diversion payments are proceeds of the debtor's crops or cows, even though the crops or milk may not have in fact been produced.[22] In these cases, the creditors' security agreements listed the livestock or crops and the proceeds, but did not claim other forms of collateral or specifically mention farm program payments. The courts have generally reasoned that the PIK payments were substitutes for the crops the debtor would have planted and that any corn or money received under a contract not to produce was, therefore, "proceeds."[23] Under this view, it was necessary for the creditor to show

22. *See* In re Lee, 35 Bankr. 663, 666-67 (Bankr. N.D. Ohio 1983) (PIK payments); In re Judkins, 41 Bankr. 369, 372 (Bankr. M.D. Tenn. 1984) (PIK payments); Apple v. Miami Valley Production Credit Ass'n, 614 F. Supp. 119, 123-24 (D.C. Ohio 1985), *aff'd*, 804 F.2d 917 (6th Cir. 1986) (PIK payments); In re Cupp, 38 Bankr. 953, 955 (Bankr. N.D. Ohio 1984) (PIK payments); In re Preisser, 33 Bankr. 65, 67 (Bankr. D. Colo. 1983) (PIK payments); Osteroos v. Norwest Bank of Minot, N.A., 604 F. Supp. 848, 849 (D.N.D. 1984) (PIK payments); In re Kruse, 35 Bankr. 958, 965 (Bankr. D. Kan. 1983) (PIK payments); In re Hollie, 42 Bankr. 111, 122 (Bankr. M.D. Ga. 1984) (milk diversion payments); Production Credit Ass'n of Fairmont v. Martin Cty. Nat. Bank, 384 N.W.2d 529, 531-32 (Minn. App. 1986) (PIK payments); First Nat. Bank v. Milford, 718 P.2d 1291, 1297 (Kan. 1986) (PIK payments); United States v. Carolina Eastern Chemical Co., 638 F. Supp. 521, 525 (D.S.C. 1986) (PIK payments).

23. *See, e.g., Lee*, 35 Bankr. at 666-67.

a nexus between its original claim and the PIK entitlements in order to claim the entitlements as proceeds. For example, a creditor with an original interest limited to a farmer's corn crop could not claim as proceeds of the corn crop entitlements arising from the agreement to not plant wheat. A creditor with an original security interest in all crops would not be so limited.[24]

A principal consequence of cases in which PIK entitlements are treated as proceeds is that a creditor's security agreement or financing statement need not claim PIK entitlements either specifically or as contract rights or general intangibles. Another consequence of such interpretations is that a purchaser of the entitlements may be justified in drawing the check for payment jointly in favor of the farmer and the crop financier.[25]

The PIK payments as proceeds/substitute crops theory has received a good deal of criticism both from courts and commentators. The criticisms are that the theory does violence to the concept of "proceeds" by extending the classification to payments received for not producing a crop and that the cases do not demonstrate an understanding of the purpose of the farm programs for which the payments were received.[26] One commentator in criticizing the "PIK as proceeds" theory argues that many of the cases so holding cite to pre-PIK cases, such as *Munger* and *Nivens*, which correctly held that federal farm program subsidy payments were proceeds, but failed to distinguish the nature of the 1983 PIK program, which was a land diversion program, from the deficiency and disaster programs involved in those cases.[27]

Farm Program Payments as General Intangibles or Other Forms of Collateral

The second school of thought concerning federal payments for not producing farm products, such as PIK payments or milk diversion payments, views the payments not as proceeds, but as other forms of collateral such as general intangibles,[28] accounts, or contract rights.[29] To date, bankruptcy courts in ten states, as well as the Seventh and Eighth Circuit Courts of Appeals, have ruled that PIK payments and milk diversion payments are not "proceeds" but are more accurately considered general intangibles, accounts, or contract rights.[30]

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24. *See, e.g., Judkins*, 41 Bankr. 369.

25. *Apple*, 614 F. Supp. at 119.

26. *See, e.g.*, Schmaling, 783 F.2d at 683-84. The court noted that while the proceeds theory had a certain appeal from an economic standpoint, that alone could not obscure the fact that the PIK payment was not a "crop" from the farmer's land. The court continued:

> Nor should the federal government's intent in managing its agricultural programs or the broad economics of the transaction override the plain language of a security agreement which extends only to crops. The rationale of the transaction cannot cure clear deficiencies in the description of the collateral.

Id. at 683.

27. Marsh, *supra* note 8, at 305.

28. In re Sunberg, 35 Bankr. 777, 780-83 (Bankr. S.D. Iowa 1983), *aff'd*, 729 F.2d 561 (8th Cir. 1984) (PIK payments).

29. In re Lion Farms, Inc., 54 Bankr. 241 (Bankr. D. Kan. 1985) (PIK payments).

30. Bank of North Arkansas v. Owens, 76 Bankr. 672, 674 (Bankr. E.D. Ark. 1987) (dairy ter-

The Iowa bankruptcy court's decision in *In re Sunberg*,[31] later affirmed by the Eighth Circuit, is generally regarded as the earliest decision representing this line of reasoning. In *Sunberg*, the court found that PIK payments could be classified as either accounts or general intangibles, which were both covered in a security agreement held by the Production Credit Association (PCA).[32] In doing so, the court avoided the "proceeds" characterization and made an enlightened interpretation of the nature of the program payments. The *Sunberg* decision is important for another reason because it is one of the few cases to address what should be the initial question in this area, namely, whether federal farm program payments are a proper form of collateral in which a security interest can be granted. The court, in addressing the no assignment-no security issue, noted that it could find nothing in the USDA regulations which would "restrict program beneficiaries from voluntarily encumbering their PIK benefits."[33] In *Matter of Hein*,[34] an Iowa bankruptcy court considered whether the failure to include "general intangibles" in a security agreement meant that a creditor's claim in deficiency payments under *Sunberg* was invalid. The court ruled that the inclusion of "contract rights," a specific form of general intangible, in the security agreement meant that the subsidy payment was covered by the security agreement.

One case that is an exception to the general observation that many courts fail to focus on the nature of the farm program for which a benefit is received is *In re Kruse*.[35] In *Kruse*, the court noted the difference between payments received to abandon a planted crop, disaster payments for low yields, and subsidy payments, all of which are proceeds, and diversion payments received for not planting, which are general intangibles.

Irrespective of the classification of farm program payments which a jurisdiction adopts, a creditor needs to comply with applicable U.C.C. requirements for the creation, attachment and perfection of a security interest in the payments. In *In re Cordes*,[36] the court held that filing a financing statement with the county as opposed to the Secretary of State rendered a bank's claim

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mination payments are not proceeds); In re Sabelka, 57 Bankr. 972, 974 (Bankr. N.D. Iowa 1986) (PIK payments); In re Mattick, 45 Bankr. 615, 617 (Bankr. D. Minn. 1985) (PIK payments); Matter of Binning, 45 Bankr. 9, 12 (Bankr. S.D. Ohio 1984) (PIK payments); In re Liebe, 41 Bankr. 965, 967 (Bankr. N.D. Iowa 1984) (PIK payments); In re Schmidt, 38 Bankr. 380, 383 (Bankr. D.N.D. 1984) (PIK payments); In re Barton, 37 Bankr. 545, 547-48 (Bankr. E.D. Wash. 1984) (PIK payments); In re Kruse, 35 Bankr. 958, 966 (Bankr. D. Kan. 1983) (PIK payments—the court ruled the payments could be either proceeds or general intangibles, depending on the reason for the payment); In re Lion Farms, Inc., 54 Bankr. 241, 244 (Bankr. D. Kan. 1985) (PIK payments); J. Catton Farms v. First Nat. Bank of Chicago, 779 F.2d 1242, 1246 (7th Cir. 1986) (PIK payments); In re Schmaling, 783 F.2d 680, 683-84 (7th Cir. 1985) (PIK payments); In re Weyland, 63 Bankr. 854, 858-59 (Bankr. E.D. Wis. 1986) (dairy herd termination payments); In re Frasch, 53 Bankr. 89, 90-91 (Bankr. D.S.D. 1985) (milk diversion payments); In re Sunberg, 35 Bankr. 777, 780-83 (Bankr. S.D. Iowa 1983), *aff'd*, 729 F.2d 561 (8th Cir. 1984) (PIK payments).

31. 729 F.2d 561 (8th Cir. 1984).
32. *Kruse*, 35 Bankr. at 781.
33. *Sunberg*, 729 F.2d at 563.
34. 65 Bankr. 112 (Bankr. N.D. Iowa 1986).
35. 35 Bankr. 958, 965 (Bankr. D. Kan. 1983).
36. 65 Bankr. 678 (Bankr. N.D. Ill. 1986).

unperfected when PIK payments were considered a general intangible.[37]

An Iowa case involving a creditor's claim to farm program benefits was resolved on a different level of analysis than the traditional "proceeds/general intangibles" dispute and illustrates how the issues are changed when a creditor specifically takes a security interest in program benefits. In *In re Brandenhorst*,[38] the debtors, who were seeking the protection of Chapter 11, granted the PCA a security interest in "all proceeds or commodities paid to the debtor by the U.S. Government under various farm programs in which debtor [was] a participant."[39] At issue was the creditor's claim to 15,000 bushels of PIK corn and $24,000 in deficiency payments for the 1984 crop year. The court had to consider three issues: (1) whether the financing statement used to perfect the security interest properly described the deficiency payments under the "proceeds" category; (2) whether the financing statement properly described PIK entitlements; and (3) whether it was inequitable for the PCA to retain a lien in the case at bar. On the first issue, the court noted that deficiency payments were traditionally treated as proceeds of a crop because they were calculated as a function of the acreage actually in production. Thus, the financing statement was sufficient. On the issue of PIK entitlements, the court noted that the issue of whether PIK entitlements should be considered proceeds of crops, general intangibles, or both "generally [arose] in the context of construing a security agreement as opposed to a financing statement."[40] Since the creditor had clearly retained a security interest in the PIK entitlements, the issue, therefore, was whether the financing statement was sufficient to perfect the security interest. The court ruled that pursuant to the "notice filing" concept of § 9-402 of the U.C.C., as adopted in Iowa, the financing statement language concerning "all. . . crops now growing or hereafter to be grown" was "sufficient to give notice to third parties that they should further inquire to determine whether PIK entitlements were included in the security agreement."[41] On the third issue, the equity of allowing the PCA to retain a lien in these payments when it had not advanced funds to the debtor in that crop year, the court held there was no evidence to support a voiding of a valid lien that was specifically described in the security agreement.[42]

While the present use of generic PIK certificates to make all different types of farm program payments may obscure some of the distinctions made in the cases interpreting 1983 PIK payments, the change in the form of payment does not make the distinction between proceeds and other forms of collateral obsolete, especially given the different precedents in the jurisdictions. For that reason, a careful reading of cases in the two schools of thought is

37. *Id.* at 680.

38. No. 86-210-E, slip op. (S.D. Iowa May 14, 1987), *aff'd on other grounds*, No. 87-1697, slip op. (8th Cir. Apr. 5, 1988) (the court held that the PIK payments were covered in the security agreement as "grain on hand," thereby avoiding the issue of whether PIK payments were proceeds).

39. *Id.* at 2.

40. *Id.* at 6.

41. *Id.* at 7.

42. *Id.* at 9.

beneficial in considering the manner in which such disputes arise as well as the variations in the level of understanding of farm programs that courts may bring to such disputes. Illustrations of the continuing significance of these cases are clearly demonstrated by court decisions in the most recent wave of farm program payment disputes, those involving the 1985 milk diversion program and the 1986 Dairy Herd Termination (DHT) program, and in recent decisions, such as *Matter of Halls*,[43] which concern the impact of restricted assignability of generic certificates. For example, in *In re Collins*,[44] a Minnesota bankruptcy court ruled that it did not need to consider whether DHT payments were "products or proceeds" of livestock because the bank had a security interest in general intangibles and that language covered DHT payments.[45]

The legal classification of federal farm program payments can be important for reasons other than determining a creditor's claim to such payments. In several recent bankruptcy cases, the eligibility of a debtor to use the new Chapter 12 family farmer reorganization provisions has hinged on whether Agricultural Stabilization and Conservation Service (ASCS) payments were classified as "farm income." Chapter 12 requires that the bankrupt must receive more than fifty percent of its gross income from farming operations.[46] In *In re Shepherd*,[47] the Federal Land Bank Association (FLBA) challenged the debtor's eligibility for Chapter 12, arguing that ASCS payments were earned for not farming and thus were not farm income. The court rejected this theory, ruling that ASCS payments were farm income and that debtors have affirmative duties under their contracts with the federal government.[48] Bankruptcy courts in Ohio and Kansas have reached similar results in Chapter 12 cases.[49]

SPECIFIC SECURITY AGREEMENT LANGUAGE COVERING FEDERAL FARM PROGRAM PAYMENTS

The most direct and effective way for a creditor to perfect a claim to a producer's federal farm program payments is to specifically provide in the security agreement that such benefits are covered, perhaps even going so far as to list the types of benefits the producer is expected to receive. Such specificity would resolve any doubt about the creditor's claim and make unnecessary such judicial distinctions as the proceeds or general intangibles distinctions previously discussed. Although this solution may seem simplistic, few of the over thirty reported federal cases decided in the last four years concerning creditor claims to farm payments have involved a security agreement that spe-

43. 79 Bankr. 417 (Bankr. S.D. Iowa 1987).
44. 68 Bankr. 242 (Bankr. D. Minn. 1986).
45. *Id.* at 243.
46. 11 U.S.C. § 101(17)(A) (Supp. IV 1986).
47. 75 Bankr. 501 (Bankr. N.D. Ohio 1987).
48. *Id.* at 504.
49. In re Welch, 74 Bankr. 401 (Bankr. S.D. Ohio 1987); In re Nelson, 73 Bankr. 363 (Bankr. D. Kan. 1987).

cifically mentioned federal farm program payments.[50]

There are at least three reasons that explain the failure of creditors to make such claims and the lack of cases showing such conduct. First, in many cases, particularly those involving the 1983 PIK program, the security agreements were written before the USDA had even contemplated the program. The litigation, therefore, involved after-the-fact efforts to salvage a secured interest in program payments. Clearly, however, given time and continued federal reliance on and expansion of federal farm programs to support farm incomes, there is little if any justification for an agricultural lender to fail to include references to federal farm program benefits in the security agreement.

A second reason for the continued failure of creditors to include references to farm program benefits is perhaps more attributable to inattention or laziness on the part of the lenders than it is to any lack of awareness or unforeseeability. Several of the courts considering this subject have indulged such creditor behavior and have given creditors the benefit of the doubt. For example, in *Sunberg*, the Eighth Circuit found it sufficient to infer that the parties were aware of the federal programs and intended such subsidies to be covered by their security agreement.[51]

One federal court, however, in its determination that the PCA's security agreement did not cover PIK and diversion payments as "proceeds," reasoned that the federal courts in Ohio have not

> indicated a willingness to rewrite security agreements based on their divination of the parties' intent or to extend the coverage of a security agreement beyond the four corners of the document.
>
> * * *
>
> Land diversion programs have been in existence in one form or another since at least 1949. As a federally chartered instrumentality operating under the auspices of the Farm Credit Administration (12 U.S.C. § 2091 et seq.) the [PCA] could hardly claim to be ignorant as to the existence and nature of the programs; nor could it claim to be unversed in drafting security agreements which adequately describe government entitlements as collateral.[52]

The case indicates the court's unwillingness to engage in semantic debates as to whether such things as diversion payments could be proceeds of crops never grown, or to infer an intention to cover such payments in a creditor's security agreement. It is better to let the creditor assume responsibility for adequately or accurately describing the nature of the collateral.

A third explanation for the lack of case authority may be that when such specific language is included, there is little left to litigate. Thus, few such cases

50. *See, e.g.*, In re Peters, 60 Bankr. 711, 714 (Bankr. D. Minn. 1986); In re Sumner, 69 Bankr. 758 (Bankr. D. Or. 1986). *See also supra* note 22 and note 30 and accompanying text.

51. *Sunberg*, 729 F.2d at 562 (citing In re Munger, 495 F.2d 511, 513 (9th Cir. 1974)).

52. *Binning*, 45 Bankr. at 13. *See also* Bank of North Arkansas v. Owens, 76 Bankr. 672, 674 (Bankr. E.D. Ark. 1987) (the court refused to hold that dairy termination payments were covered by a clause which included "all benefits which arise from the described property including cash or non-cash proceeds," and property which results from the described property).

are reported. While there is a danger in reasoning by negative inference, the explanation is at least plausible.

Creditor practices concerning the treatment of federal farm program payments in security agreements used with agricultural loans may be changing. The following is the relevant language from a security agreement the author signed in January 1987, to secure an agricultural loan:

> . . . all contract rights, chattel paper, documents, accounts and general intangibles, whether now or hereafter existing or acquired, any right to performance, entitlement to payment in cash or in kind, or other benefits under any current or future governmental program.

The specific language contained in this security agreement, if present, would have resolved the creditors' problems in most of the cases previously discussed in this article. While such retrospective correction of documentation problems is not possible, prospective prevention of such disputes clearly is.

DIRECT ASSIGNMENT OF PRODUCER BENEFITS

The Assignment Procedure

Another method that a creditor can use to secure a claim to farm program benefits is to take a direct assignment of the payments under USDA regulations. The statute authorizing farm programs provides the following:

> A payment which may be made to a farmer under this Section may be assigned, without discount, by him in writing as security for cash or advances to finance making a crop, handling or marketing an agricultural commodity, or performing a conservation practice. . . . Such assignment shall not be made to pay or secure any preexisting indebtedness.[53]

USDA regulations for farm program administration establish an assignment procedure that reflects this authorization.[54]

While the assignment procedure may appear to be an attractive option to creditors who are seeking additional methods of securing agricultural loans on the basis of future farm program payments, the assignment procedure is not free from important legal questions and limitations. The questions most fre-

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53. 16 U.S.C. § 590h(g) (1982).

54. 7 C.F.R. Part 709, Assignment of Payments (1987). Contracts for producer participation in federal agricultural price support programs and ASCS regulations provide that a producer may voluntarily assign his benefits to another party. For example, the contract to participate in the 1987 Price Support and Production Adjustment Program provides that the ASCS rules on assignment of payment are incorporated by reference into the contract. CCC-477 Appendix, Paragraph 10D.

The ASCS uses a special form to document assignments, Form ASCS-36 "Assignment of Payments." The form and the rules for assignment incorporate language which significantly restricts the purposes for which assignments can be made. The form provides that payments may be assigned only as security for:

a. Cash, supplies, or services advanced or to be advanced to the producer to enable him/her to produce, handle, or market a crop or to perform a conservation practice.
b. Food, clothing, or other necessities advanced or to be advanced to the producer or his/her dependents, or cash advanced or to be advanced to buy these items.
c. Payments of cash rent for land used by the producer to make a crop or the repayment of cash advanced for the payment of such cash rent.

quently addressed are: (1) whether the existence of an assignment procedure means that it is the only method by which a creditor can claim a producer's farm program benefits; and (2) if a properly executed assignment exists, what is the effect of an assignment made to a creditor with a junior claim or the failure of the ASCS to make payments pursuant to the assignment. The limitations on assignments include the restriction on the purposes for which assignments can be made and recent USDA regulations making generic commodity certificates non-assignable.

The No Assignment-No Security Interest Interpretation

The majority of cases in which the assignment issue has been considered involve claims by the debtor that the assignment procedure is the only method whereby a creditor can claim an interest in federal farm program payments. Failure to comply with assignment requirements invalidates the creditor's security agreement claim.[55] The cases can be characterized as attempts to interpret the assignment procedure as meaning that federal farm payments are to be otherwise free of creditor claims and thus "new money." This reading of the assignment procedure has been rejected by the Seventh[56] and Eighth[57] Circuit Courts of Appeals as well as other federal courts.[58] A small minority of bankruptcy courts, however, has adopted the argument.[59]

The "no assignment-no security interest" theory is based on provisions in the farm program contracts and regulations *on assignment* which provide that payments will be

> made without regard to questions of title under state law, and without regard to any claim of lien against the commodity, or proceeds thereof, which may be asserted by any creditor.[60]

The Eighth Circuit interpreted the language in *Sunberg* to be for the purpose of protecting the government if an assignment is made and payments given to a wrong party, not as an "anti-assignment clause." The court continued as follows:

> These provisions merely govern the rights of parties claiming PIK benefits directly from the federal government. They do not prevent one who is entitled to the benefits from pleading the benefits as security on loans properly made under state law. Simply because the government will refuse to deliver the benefits to an assignee not appearing on the proper federal forms does not mean that an assignor can totally disregard legal obligations to the assignee. Such "anti-assignment" provisions are in-

55. *See, e.g.*, In re Nivens, 22 Bankr. 287, 290-91 (Bankr. N.D. Tex. 1982).
56. *J. Catton Farms*, 779 F.2d at 1246.
57. *Sunberg*, 729 F.2d at 563.
58. *See supra* note 20.
59. *See, e.g.*, In re Bechtold, 54 Bankr. 318 (Bankr. D. Minn. 1985); In re Azalea Farms, 68 Bankr. 32 (Bankr. M.D. Fla. 1986); In re Bearce, No. 86-40019, slip op. (Bankr. D. Kan. Aug. 13, 1987).
60. This quote is from the ASCS regulations for assignment that were in place during the 1983 PIK program. *See* 48 Fed. Reg. 9235 (1983) codified at 7 C.F.R. § 770l.6(f) (1987) (emphasis added).

> tended to insulate the government as benefit provider from conflicting claims over payments, not to preempt state commercial law as between third parties. (citations omitted) Neither do we read anything in other PIK regulations to restrict program beneficiaries from voluntarily encumbering their PIK benefits.[61]

Courts in several other jurisdictions have reached similar results for similar reasons.[62]

In 1985, a bankruptcy court in Minnesota made a different interpretation of the assignment language in reviewing a dispute over a creditor's claim to milk diversion payments. The court focused on the regulatory language restricting the purposes for which the assignment could be made. The court concluded that "taken as a whole the regulations clearly indicate that the Secretary of Agriculture in adopting the regulations intended that milk diversion payments be free of claims by others and therefore provide cash for farmers to use to finance a new crop."[63] The court noted that the regulations against assignments for preexisting debt were not raised in *Sunberg* and, if they had been raised, perhaps the court's outcome would have been different. Given that the Minnesota court's "federal payments as new money" holding requires interpreting the ASCS assignment rules as preempting the application of state commercial law to federal farm program payments, it seems questionable that the Eighth Circuit would have reached that result even if the rules had been raised, in light of their reasoning in *Sunberg*.

The "federal payments as new money" theory was adopted by a Florida bankruptcy court in a decision involving creditor claims to milk diversion payments. In that case, no assignment of payment form was filed; but, even if one had been filed, it would not have been effective in light of the court's holding:

> "[T]he regulations, taken as a whole clearly indicate that the Secretary of Agriculture in adopting the regulations intended that milk diversion payments be free of claims and therefore provide cash to farmers in order to finance farm operations."[64]

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61. *Sunberg*, 729 F.2d at 563.

62. For example, the court in *In re Nivens*, had earlier considered the failure to assign claims and concluded the following:

> Nothing in the statutes or in the regulations indicates that ASCS monies cannot be used as collateral for crop loans obtained by the recipients. Accordingly, I conclude that the claim by the bank and by the SBA of security interest is not defeated by the fact that Assignment of Payment Form ASCS-36 was not executed and filed with the county office of ASCS.

Nivens, 22 Bankr. at 291. *See also Preisser*, 33 Bankr. at 67; *Lee*, 35 Bankr. at 666-67.

63. *Bechtold*, 54 Bankr. at 321.

64. *Azalea Farms, Inc.*, 68 Bankr. at 32. While the majority of courts have rejected the "no assignment-no security interest" theory, one of the majority opinions does give some support to the *Bechtold* theory, *in dicta*. *See J. Catton Farms*, 779 F.2d 1242:

> Catton might conceivably have gotten some mileage out of 7 U.S.C. § 1444d(i), which applies to the "PIK" program the payment provisions of the Soil Conservation and Domestic Allotment Act, including a provision which forbids assigning payment rights to "secure any preexisting indebtedness." 16 U.S.C. § 590h(g). The evident purpose is to make sure that the intended beneficiary of federal largess retains the benefit. See *Barlow v. Collins*, 397 U.S. 159, 162-65, 90 S. Ct. 832., 835-36, 25 L.Ed.2d 192 (1970). If there is no fresh consideration for the assignment, he does not. In this case, however, putting to side the fact that Catton is a substantial corporation rather than a tenant farmer as in the *Barlow* case, the assignment—if that is what one should call the provision in the loan agreement giving the bank a security

A recent unreported Kansas bankruptcy court ruling illustrates the continued confusion over the "farm payments as new money/no assignment-no security interest" theory and the relation of this theory to restrictions on the purposes for which assignments can be made. In *In re Holman*,[65] the court had to consider whether a creditor's failure to take an assignment meant that a security agreement, amended to specifically include all "ASCS program payments," was "an assignment for a preexisting debt" which would fail under the statute and regulations, thus allowing the trustee to claim the payments.[66] The secured creditor argued 16 U.S.C. § 590h(g)[67] was intended only to cover direct assignments under the procedure of 7 C.F.R. Part 790, not assignments taken as security. The court disagreed in its ruling:

> The plain language of § 590h(g) leads this Court to conclude that this section may indeed be applicable to assignments given as security. The section states that "a payment which may be made to a farmer, . . . may be assigned . . . *as security* . . . and that such assignment shall not be made to pay *or secure* any preexisting indebtedness." (emphasis added) This language contemplates two transactions: (1) an assignment to pay, which would constitute an outright assignment, or (2) an assignment to secure, which would constitute a collateral assignment or, in other words, the granting of a security interest in such payments. This Court finds it unnecessary to reach a final conclusion regarding the meaning of "security interest" language contained in § 590h(g), however. Even if 16 U.S.C. § 590h(g) covers the granting of security interest, it cannot be applied in this instance to invalidate the security interest granted as no "antecedent debt" or "preexisting indebtedness" is involved.[68]

The Court went on to explain how in this situation the security interest was not for a preexisting debt:

> The type of "preexisting indebtedness" prohibited by § 590h(g) would arise in the following situation: on day one creditor extends a loan to debtor, which is unsecured. On day thirty debtor assigns to creditor its right to receive certain ASCS payments as security for the funds loaned on day one. This factual scenario is quite different from the facts at hand. The Debtors did *not* assign the ASCS payments and certificates to PCA on November 7, 1983 to secure indebtedness already owed to PCA. Rather, Debtors assigned the ASCS payments and certificates to secure repayment of a loan in the amount of $93,189.88 being made contemporaneously. The Security Agreement memorializes a *present grant* by the Debtors of a security interest in certain collateral in exchange for the *present* loan of approximately $93,000. That the ASCS payments

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interest in any contract rights (implicitly including "PIK" contract rights) that Catton might acquire—was made not to secure a preexisting indebtedness but as part of the inducement to the bank to make the loan; so the "farmer" got value for the assignment. In any event, Catton, not having cited either of the above statutory provisions to us, waived any reliance it might have placed on them.

Id. at 1246.

65. No. 86-40959, slip op. (Bankr. D. Kan. Jan. 22, 1987).
66. *Id.* at 8.
67. *See supra* note 49 and accompanying text.
68. *Holman*, No. 86-40959, slip op. at 5-6.

> were not yet in existence as of November 7, 1983, when the loan was made and the Security Agreement executed is not controlling and certainly does not render the debt incurred "preexisting indebtedness." Rather, the Debtors' granting of a security interest in the ASCS payments simply constitutes the granting of a security interest in "after-acquired property." K.S.A. § 84-9-204(1).[69]

Finally, the court rejected the trustee's theory that § 590h(g) requires that the cash or advances to be secured by the ASCS payments must be used to finance the making of a crop to which the ASCS payments directly relate. The court noted that the

> . . . section states that ASCS payments that *may* be made to a farmer *may* be collaterally assigned to secure a loan given to finance the "making of a *crop*." (emphasis added) The drafter's use of the permissive terms "may" and the general identification of "a crop" is evidence of intent to include any and all ASCS payments that may be received by the farmer in the future, not just those payments to which the farmer presently has rights or which he is presently receiving, and any and all crops that the farmer might grow in the future, not just those crops which are to be grown or are growing in the year in which the loan is made.[70]

The *Holman* case is of interest because it expands the interpretation of 16 U.S.C. § 590h(g) beyond direct assignments for payment made under the USDA procedure to include assignments for security as established by security agreements under the U.C.C. While this analysis was not present in *Sunberg* and other earlier cases, the *Holman* analysis may foreshadow future judicial consideration of cases involving payments. Even though legality of claims to future crops is clear, at least one lender's association was advised by counsel in early 1987 to be wary in light of *Bechtold* and its progeny.[71]

A recent Iowa bankruptcy court decision underscored the wisdom of that advice and serves to increase the confusion over the treatment of farm program benefits. In *Matter of Halls*,[72] the court addressed the claim of the Federal Deposit Insurance Corporation (FDIC) in a farm debtor's 1986 and 1987 farm program benefits.[73] In 1986, the debtor borrowed money from the FDIC's predecessor bank and gave a security interest specifically covering:

> entitlements and payments from all state or federal farm programs, whether now owned or existing or hereafter existing or acquired; . . . and the proceeds of any government farm program.[74]

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69. *Id.* at 6.
70. *Id.* at 7-8.
71. *See* IOWA BANKERS ASS'N, *Using Government Farm Program Benefits as Collateral*, AGRIC. BULL. (Apr. 22, 1987) stating the following:

> In Iowa, it appears that PIK certificates can be assigned as security for a debt incurred to finance making a crop, handling or marketing an agricultural commodity, or performing a conservation practice. It is not really settled as to whether assigned PIK certificates can be taken to secure a preexisting debt and it would at this time be best to avoid doing so.

Id. at 3.
72. 79 Bankr. 417 (Bankr. S.D. Iowa 1987).
73. *Id.* at 418-22.
74. *Id.* at 418.

In considering the validity of the FDIC claim, the court distinguished between payments earned in 1986 and 1987. The court, implicitly relying on the unreported *Holman* decision, premised its analysis on the basis that the FDIC's security interest must be measured against the language of the federal regulations concerning the assignment procedure. Because those regulations provide that assignments cannot be made to secure preexisting indebtedness, as ruled in *Bechtold* and *Azalea Farms*, the court concluded, that "the FDIC cannot encumber 1987 program payments because the FDIC provided no financing for the 1987 crop."[75] The court noted that for cash benefits earned in 1986 whether paid in 1986 or 1987, the FDIC would have a claim; but as to the cash benefits paid for the 1987 crop, the FDIC claim was invalid because under the "no assignment for preexisting debt" provisions, payments relating to a crop for which the creditor had no part in making were not subject to the creditor's security interest.[76]

The court also concluded that as to the benefits paid in the form of generic certificates, because the regulations provide that such benefits are not assignable, the FDIC did not have a security interest in any benefits paid in the form of certificates, ruling that "the certificates cannot be encumbered by nongovernment creditors."[77] The *Halls* decision is essentially an adoption of the *Bechtold/Holman* analysis. The creditor in *Halls* argued that the "no assignment-no security interest" theory was contrary to the Eighth Circuit's conclusion as to the purpose of the assignment procedure reached in *Sunberg*, but the *Halls* court ruled that *Sunberg* was "inapposite" because it dealt with an earlier version of the assignment regulations. The court went on to conclude that state commercial law was not applicable to the consideration of farm program payments because there was a conflict between the federal assignment language and state commercial law, and the federal rules must control over state law.[78]

The result in *Halls* is subject to criticism for several reasons, especially for the failure to recognize a difference between use of the assignment procedure set out by federal regulation and the availability of state commercial law to control the treatment of security interests in farm program benefits. While perhaps perceived as a pro-farm debtor decision, *Halls* may result in an inability to use federal farm program benefits as collateral to secure agricultural lending. The decision is one of the first to consider the nonassignability of generic certificate provisions, which are discussed below.[79] As that discussion indicates, in light of the regulatory language chosen by the USDA, the court's confusion may be justified and certainly predictable. A central legal and policy concern with the *Halls* analysis, which equates the term "assignment" with consensual commercial law liens, is that the enforceability of a secured credi-

75. *Id.* at 419.
76. *Id.* (citing 7 C.F.R. § 709.3(a)).
77. *Id.* at 421 (citing 7 C.F.R. § 770.6).
78. *Id.*
79. *See infra* text accompanying notes 88-100.

tor's claim against farm program benefits depends entirely on two facts: (1) whether the payment was made in cash or in generic certificates, and (2) whether the creditor financed the making of the crop in the year the payment was received, thereby ignoring both the purpose for which the farm program benefit was being received and the specific language of the lenders consensual lien. While these considerations may be relevant, they do not appear to justify the result in *Halls* or provide a sufficient basis on which to rest the availability of farm payments as collateral, especially in light of the fact that the form of payment, cash or certificates, is essentially a decision made by the USDA for budgetary reasons unrelated to the purposes for which the payments are made.

Perhaps the most innovative attempt to use the anti-assignment authority to protect a debtor's farm program payments from the reach of another was in *In re Pritchard*.[80] The debtor argued that reading 16 U.S.C. § 590h(g) and 7 U.S.C. § 1444e(k) together created a "federal bankruptcy exemption" which could be used to claim ASCS payments exempt from Chapter 7 trustees. The court rejected this theory, noting that the statutes do not contain any language exempting such payments from seizure under a collection process, the common element in exemption statutes. The court noted that the anti-assignment provisions

> [limit] the extent to which the entitlement may be reached by, or encumbered in favor of, a creditor, by prohibiting assignment to secure preexisting debt and limiting assignment to new financing for crop inputs, handling, and marketing, or for resource conservation activity. However, anti-assignment provisions only operate to restrict, prohibit, or invalidate consensual assignments by a debtor-beneficiary; they do not prohibit involuntary attachment by collection process.[81]

Cases in Which Assignment Was Attempted

Even when a creditor attempts to follow the direct assignment procedure, payments may not be received. Few reported cases involve situations where a creditor has taken a direct assignment of the producer's benefits. In those cases where assignments were made, however, the assignment was either ruled ineffective,[82] or the court did not resolve the issue.[83]

In a 1986 Iowa case, a bankruptcy court ruled that a bank's use of the ASCS assignment process for PIK benefits was meant to provide additional security for its loan to the producer; however, the inadequacy of the description of the property on which the crops were to be grown (or not grown in this case), which defeated the U.C.C. security interest claim, also defeated the bank's assignment claim.[84] The court, citing the Eighth Circuit's *Sunberg* de-

80. 75 Bankr. 877 (Bankr. D. Minn. 1987).
81. *Id.* at 879.
82. In re Barton, 37 Bankr. 545 (Bankr. E.D. Wash. 1986).
83. In re Sabelka, 57 Bankr. 972 (Bankr. N.D. Iowa 1984).
84. *Id.* at 974-75.

cision, reasoned that the assignment process did not preempt the U.C.C.:

> "These federal regulatory provisions [did] not help the bank in avoiding the requirements of the Iowa Uniform Commercial Code in establishing a valid security interest good as against a trustee in bankruptcy."[85]

Another recent case involved a producer's assignment of PIK payments to a farm supply company to cover the costs of services such as aerial spraying, but the court ruled it did not have a sufficient basis to determine the priority of a competing secured creditor's claim.[86]

A third question that can arise concerning the assignment process is the effect of an assignment to a junior lienholder or unsecured creditor on a secured creditor's claims. The ASCS regulations clearly indicate that the agency will not become a party to such disputes and reserves the right to make the payments to the assignee.[87] A secured creditor with a higher priority claim to the payments under state commercial law would have to assert the claim in court, such as was done in *Sunberg*, and argue that the federal rules do not preempt state commercial law.

Regulatory Actions and Creditor Claims to Farm Program Payments

Recent USDA regulatory actions on two issues help complicate the issue of creditor claims to federal farm program payments. First, the final rules promulgated to implement the 1985 farm bill amended the regulations concerning "Commodity Certificates, In Kind Payments and Other Forms of Payment" to provide the following:

> "Notwithstanding any other provision of this chapter, a payment made under this part may not be the subject of an assignment, except as determined and announced by the CCC."[88]

The effect of this section is that the ASCS will not consider using the direct assignment for payment procedure of 7 C.F.R. Part 709 for payments made in forms other than cash, unless it announces otherwise, which to date it has not done.

A second and perhaps even more confusing regulatory development creates a larger cloud on the horizon for creditor claims to farm program payments made in the form of generic commodity certificates. The generic PIK

85. *Id.* at 974. The court's opinion could perhaps be criticized for failing to recognize the assignment process as a separate procedure for claiming federal payments, as contrasted to *Sunberg*, where the issue was a dispute with a third party claiming the payments, rather than the original creditor or assignee. The court's opinion would appear to render the assignment process of no value to a creditor if there exists a separate security agreement between the parties. When viewed in that light, the case seems to limit the value of the "no assignment-no security interest" theory.

86. *Barton*, 37 Bankr. at 547.

87. 7 C.F.R. § 709.8 provides as follows:

> Neither the Secretary nor any disbursing agent shall be liable in any suit if payment is made to the assignor without regard to the existence of any assignment, and nothing contained herein shall be construed to authorize any suit against the Secretary or any disbursing agent if payment is not made to the assignee, or if payment is made to only one of several assignees.

88. *See* 7 C.F.R. § 770.6, Assignments (1987); 51 Fed. Reg. 36923 (1986). The part concerns forms of payment other than cash.

certificate which is now used to make many farm program payments, provides the following condition:

> This certificate shall not be subject to any state law or regulation, including but not limited to state statutory and regulatory provisions with respect to commercial paper, security interests, and negotiable instruments. This certificate shall not be encumbered by any lien or other claim, except that of an agency of the United States Government.[89]

The Secretary of Agriculture is authorized in the creation of federal farm programs to override the application of state law, such as the Uniform Commercial Code, if necessary. The statute authorizing the Commodity Credit Corporation (CCC) provides the following scope:

> State and local regulatory laws or rules shall not be applicable with respect to contracts or agreements of the Corporation or the parties thereto to the extent that such contracts or agreements provide that such laws or rules shall not be applicable, or to the extent that such laws or rules are inconsistent with such contracts or agreements.[90]

Under this language, the Secretary could, if it was determined necessary, provide that benefits received by producers under federal farm program benefits are not subject to laws arising under state law. Such a theory could make the proceeds of such benefits unencumberable and, as a result, be like "new money" to the producer. This is the result for which some producers have argued under the assignment authority, but that was rejected in decisions like that of the Eighth Circuit in *Sunberg*.

The question that arises when one reads the language of the generic PIK certificate is whether the agency intends that such payments be preempted from the application of state commercial law claims. The answer appears to be that the USDA in fact originally took this approach in the treatment of generic PIK certificates used in 1986 and 1987, although the agency has subsequently backed off of its initial broad interpretation.

In March 1986, the ASCS promulgated regulations providing for the implementation of the 1985 Food Security Act, or farm bill.[91] The regulations included a new 7 C.F.R. Part 770 entitled Commodity Certificates, In Kind Payments, and Other Forms of Payment.[92] The rules for commodity certificates provided the following:

> State law and regulations shall not be applicable to the issuance, transfer, or redemption of commodity certificates. Commodity certificates, *or the proceeds thereof*, may not be subjected to any claim or lien by any creditor except agencies of the U.S. Government.[93]

This language replaced the somewhat similar language of the existing PIK regulations.[94] The broad wording of the rule to cover liens on both the com-

89. CCC-6, Paragraph 3, Commodity Credit Corporation Commodity Certificate.
90. 15 U.S.C. § 714b(g) (1982).
91. 51 Fed. Reg. 8428 (1986).
92. 51 Fed. Reg. 8451-8453 (1986).
93. 51 Fed. Reg. 8453 (1986) (emphasis added).
94. 7 C.F.R. § 770.5(f) (1987).

modity and its proceeds would have the legal effect of shielding all federal farm program payments received in the form of PIK certificates from preexisting claims of creditors under state commercial law. Such an interpretation would have had a fundamental impact on the ability of creditors to finance a farm operation that participated in federal farm programs.

The March rule was an interim rule, however, and the ASCS on June 16, 1986, promulgated another interim rule modifying 7 C.F.R. Part 770 concerning PIK certificates.[95] The new rule, which was made final in October, provided at 7 C.F.R. § 770.4(b)(2) the following:

> Commodity certificates shall not be subject to any lien, encumbrance or other claim or security interest, except that of an agency of the United States Government arising specifically under federal statute.[96]

The significant difference between the final version of the rule and the March version is the removal of the "or proceeds thereof" clause.

Three important questions arise in relation to this change: (1) what is the effect of the change; (2) why did the ASCS make the change; and (3) what is the USDA's reason for exempting PIK certificates from the operation of state law. The answer to the first question is clear although the magnitude of the effect may be less so. The removal of the proceeds language means that the ASCS apparently does not care what happens to the money once it is paid over to a producer upon the transfer or redemption of PIK certificates. The proceeds of the certificates are, therefore, available for creditors who may claim the proceeds under preexisting security agreements. The nature of such claims and the court's interpretation of security agreement language as illustrated by the cases previously discussed are in stark contrast to what the outcome would be if the USDA rules provided that the certificates and the proceeds were unencumberable (e.g. exempt from creditors' claims under state law) except as allowed for in the rules on assignment of payments.

The answer to the second question, why the agency made the change, is less clear. The agency's discussion of the proposed rules provides no insight into the rationale for the shift. It is not unreasonable to speculate that concerns from financial institutions contributed to the change. In addition, it appears that the earlier version of the rule went further than the USDA found necessary to protect the agency's interest in the matter, which brings into focus the third question, why commodity certificates are exempted from state law claims.

The USDA's rationale for the rule making PIK certificates unencumberable is to preserve the transferability of the certificates. This was necessary for the documents to be freely traded and thus function as intended in creating an ancillary system to facilitate reduction of government-owned stocks and to

95. 51 Fed. Reg. 21835 (1986).

96. *Id. See also* 51 Fed. Reg. 36921 (1986). 7 C.F.R. § 770.4(b)(1) (1987) provides as follows: The provisions of this section or the commodity certificates shall take precedence over any state statutory or regulatory provisions which are inconsistent with the provisions of this section or with the provision of the commodity certificates.

help market price adjustments. In the USDA's view, a creditor's obtaining possession of the PIK certificates (which are negotiable) from the producer would interfere with the functioning of the generic PIK certificate system. Therefore, the USDA relied on the broad statutory supremacy power cited above to override the application of state commercial law to the certificates.

A letter from the USDA Office of General Counsel helps clarify the fact that the USDA's intention in employing the restrictive language of the certificates and regulations was limited to the certificates, not the proceeds.[97] The letter, after explaining the purpose of limiting claims to the certificates, concludes:

> [T]herefore, commodity certificates are not subject to any claim or lien, except as specifically provided for in the applicable regulations. With respect to proceeds from the sale of a commodity certificate or commodities acquired through the use of a certificate, the regulations do not attempt to preempt State law concerning the applicability of claims or liens.[98]

The USDA's interpretation of this rule is important for several reasons. First, the rule should help clarify any questions a court or creditor may have about the possible attachment of a generic PIK certificate under state commercial law. Second, it is not unreasonable, however, to expect producers to argue, and the courts, such those in *Bechtold*[99] and *Halls*,[100] to accept a broader interpretation of the language of the PIK certificates to mean that the certificates *and the proceeds* are "new money" and unencumberable under the federal rules. It is at this point that the USDA's interpretation of its regulations may become crucial to resolving what would be a legal issue affecting creditors' claims to literally billions of dollars of federal farm program benefits.

POST-PETITION PROPERTY IN BANKRUPTCY

Even though a creditor may have taken sufficient measures to secure a claim in a debtor's federal farm program payments, other problems may prevent the creditor from obtaining these payments. One of the most serious obstacles may be § 552 of the Bankruptcy Code, which may prevent creditors who had pre-petition claims from obtaining farm program payments received after the bankruptcy filing.[101]

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97. Letter from Thomas V. Conway, Associate General Counsel, International Affairs, Commodity Programs and Food Assistance Programs, U.S.D.A. Office of General Counsel, to Neil D. Hamilton (Apr. 14, 1987) (on file with author).

98. *Id.*

99. *See supra*, discussion in text accompanying note 63.

100. *See supra*, discussion in text accompanying notes 72-79.

101. 11 U.S.C. § 552 (1982 & Supp. IV 1986). The section provides the following:

> (a) 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.
>
> (b) Except as provided in sections 363, 506(c), 522, 544, 545, 547, and 548 of this title, if the debtor and a secured party enter into a security agreement before the commence-

The application of the post-petition property clause depends on two considerations, namely, whether the court considers the payments as proceeds and when the debtor's right to the payments arose. Many of the cases discussed above, in which courts determined that certain forms of farm program payments were proceeds of crops, involved § 552 issues. For example, in *Matter of Hollie*,[102] the bankruptcy court determined that milk diversion payments were proceeds of milk in which the Farmers Home Administration (FmHA) had a security interest, and even though the milk diversion contract was entered into after the bankruptcy filing, § 552(b) applied and preserved the FmHA's lien.[103]

In other cases, for example, the bankruptcy court's decision in *Sunberg*, the court determined that PIK payments were proceeds for purposes of § 552 and that the contract was entered into prior to the bankruptcy filing.[104] The court noted that the term "proceeds" in § 552 was not limited to the technical definition of the U.C.C.[105] Courts have ruled, however, that if the debtor signed the contract to receive federal payments after filing bankruptcy and if the payments could not be described as "proceeds," the creditor's lien was extinguished. For example, in *In re Kruse*,[106] the court determined that the PIK payments were a general intangible acquired by the estate after the petition was filed and thus free of pre-bankruptcy liens due to § 552(a).[107]

In a recent Minnesota case, the court determined that the debtor entered the Dairy Herd Termination program after filing for bankruptcy.[108] As a result, although the bank's lien against the cattle for their value as dairy cattle would continue, the bank had no interest in the producer's DHT payments which the court treated as post-petition property. The court ruled "the bank had a security interest in the cattle, not in the debtor farmer's farming expertise."[109] In another case in which the DHT contract was signed prior to filing for bankruptcy, the court ruled that the exception under § 552(b) applied and the creditor's lien was preserved.[110]

Two Iowa bankruptcy opinions are worthy of note on the question of § 552 application. In *In re Fowler*,[111] the court distinguished the *Sunberg* de-

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ment 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, product, offspring, rents, or profits of such property, then such security agreement 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 nonbankruptcy law, except to the extent that the court, after notice and a hearing based on the equities of the case, orders otherwise.

102. 42 Bankr. 111 (Bankr. M.D. Ga. 1984).
103. *Id.* at 119.
104. 35 Bankr. 777, 783-84 (Bankr. S.D. Iowa 1983).
105. *Id. See also J. Catton Farms,* 779 F.2d at 1246.
106. 35 Bankr. 958 (Bankr. D. Kan. 1983).
107. *Id.* at 966.
108. Grunzke v. Security State Bank of Wells, 68 Bankr. 446 (Bankr. D. Minn. 1987).
109. *Id.* at 449. The bank was, however, entitled to a lien upon DHT proceeds to the extent it was prejudiced by selling the cattle at slaughter value rather than fair market value. *Id.*
110. In re Collins, 68 Bankr. 242 (Bankr. D. Minn. 1986).
111. 41 Bankr. 962 (Bankr. N.D. Iowa 1984).

cision by noting that the PIK contract was not entered into until after the bankruptcy filing, and thus, the payments were post-petition property.[112] The other case provides important guidance on the question of determining when federal farm payments are considered to be received for purposes of the post-petition property rule. In *In re Liebe*,[113] the parties assumed that the PIK entitlements came into existence on the date the debtor filed the application to enroll in the program, which was prior to the bankruptcy filing. The court determined, however, that the right to the payments was not effective until the PIK contract was approved and signed by a representative of the CCC, which was done after the debtor filed for bankruptcy, rendering the creditor's lien extinguished under § 552.[114] Another recent case involved a question of timing when producers' payments are credited by the ASCS against CCC debts for purposes of determining farmer indebtedness in eligibility for Chapter 12.[115]

One question that must be addressed in considering the post-petition issue is whether the debtor's rights to the payments are properly classified as pre-petition property, in which case preexisting creditor claims can be upheld, or if the right to payment will be considered as arising post-petition, in which case a creditor's pre-petition claim will not be enforced. The question is often considered in the context of an agency request to exercise an offset in bankruptcy under § 553. In one case, a bankruptcy court in Texas held local FmHA officials in contempt of court for attempting to use administration offset to obtain a farmer's payments.[116] The court concluded that the monies due the debtor from the ASCS were post-petition and, therefore, could not be set off against pre-petition indebtedness.[117] A similar result was reached by a bankruptcy court in Vermont, which ruled in a Chapter 7 case that a debtor's entitlement to benefits under the milk diversion program had not been sufficiently established at the time the bankruptcy was filed to make the payments property of the estate.[118] A more recent Minnesota case reached the opposite conclusion, holding that deficiency payments not yet received were pre-petition obligations subject to set off by the ASCS.[119] The trustee had argued that because the amount of deficiency payments, or even eligibility to receive the payments, would not be determined until after the end of the growing season; therefore, the payments could not be a pre-petition obligation. The district court, however, agreed with the bankruptcy court that

> . . . under the overall scheme of the deficiency program the various contract requirements are in the nature of contractual duties and promises

112. *Id.* at 963-64.
113. *Id.* at 965.
114. *Id.* at 968.
115. *See* In re Stedman, 72 Bankr. 49 (Bankr. D.N.D. 1987).
116. In re Hill, 19 Bankr. 375 (Bankr. N.D. Tex. 1982).
117. *Id.* at 380.
118. In re Lamb, 47 Bankr. 56 (Bankr. Vt. 1985).
119. Matter of Matthieson, 63 Bankr. 56 (Bankr. D. Minn. 1986). *But see* In re Walat Farms, Inc., 69 Bankr. 529 (Bankr. E.D. Mich. 1987) and *infra*, text accompanying notes 127-136.

rather than conditions precedent.[120]

The court noted that the government's obligation to pay the benefit was binding from the inception of the contract, thereby subjecting pre-petition obligations to offset under § 553.

Another problem threatening creditor claims may be unusual provisions of state commercial law. An example of a unique U.C.C. provision apparently enacted to protect farm debtors from the overreaching actions of secured creditors, but which can affect a creditor's interest in farm program payments, is a North Dakota provision concerning security agreements covering crops which also include other types of personal property. The law provides the following:

> *Security Agreement not to include other personal property.* A security agreement covering specific crops is not valid to create a security interest therein, nor entitled to be filed in the office of the register of deeds, if the security agreement contains any provision by which a security interest is claimed in any other personal property.[121]

This unique provision has been considered in three reported cases;[122] but in the most recent of these, the court reached the somewhat implausible result that because government farm program payments were "proceeds," they were a form of personal property. Thus, the inclusion of "crops" and "proceeds" in the same security agreement violated the statute.[123]

SET-OFFS BY FEDERAL AGENCIES

Another obstacle that a creditor might face in obtaining a debtor's federal farm program payment is a claim of set-off by another federal agency. ASCS rules provide for such set-offs when a producer owes money to another department or agency of the government.[124] At least one court has held that the Internal Revenue Service was entitled to a set-off to the extent of pre-petition tax liens out of the milk diversion payments which the secured creditor was claiming.[125] In another case, a bank's security interest in a farmer's deficiency payment was determined to be superior to a perfected lien of the Small Business Administration (SBA), meaning that there was no payment left against which the SBA could offset.[126]

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120. *Matthieson*, 63 Bankr. at 59. The court relied on *In re Lee* for the analysis that once a debtor has contracted to participate in a farm program, the various requirements for receipt of payment were contractual obligations and not conditions precedent.

121. N.D. CENT. CODE § 35-05-04 (1987).

122. *See* In re Yagow, 62 Bankr. 73 (Bankr. D.N.D. 1986); In re Kingsley, 73 Bankr. 767 (Bankr. D.N.D. 1987).

123. *Kingsley*, 73 Bankr. at 771. The court noted the bank's argument that such a conclusion would eliminate all methods of obtaining a valid crop lien in North Dakota, because "proceeds" are included by operation of law under U.C.C. § 9-306. The court ruled there is a difference between prohibiting the express inclusion of proceeds and the continuation of a security interest in proceeds by operation of law. The court noted that if creditors want to maintain security interests on both the crops and the government payments, they would need to draft separate security agreements.

124. 7 C.F.R. § 13.1 (1987) provides the rules under which payments to be disbursed by the ASCS may be withheld or set off against debts the person owes to any department or agency of the United States. *See also* 7 C.F.R. § 713.153 (1987).

125. In re Schons, 54 Bankr. 665, 667-68 (Bankr. W.D. Wash. 1985).

126. *Nivens*, 22 Bankr. at 292. The main problem with the SBA's claim of set-off was the fact that

The right to set-off can arise under the Bankruptcy Code as well as under USDA regulations. In an Iowa bankruptcy case, the court determined that the Commodity Credit Corporation (CCC) was entitled to a right of set-off under 11 U.S.C. § 553(a).[127] The debtor owed the CCC over $26,000 due to a deficiency in the repayment of a 1981 corn loan. The CCC owed the debtor over $19,000 for participation in the 1984 Milk Diversion Program (MDP). In this proceeding, the CCC asked for relief from the stay in order to exercise its right of set-off and to keep the final MDP payment that was the property of the estate under Bankruptcy Code § 541(a). The government's effort was resisted by a secured creditor who claimed an interest in the debtor's farm collateral. The court determined that the payment was the property of the estate and that the CCC was entitled to exercise a right of set-off under 11 U.S.C. § 553(a). The court granted the CCC relief from the stay to exercise its right, and ruled that it did not have jurisdiction to decide the lien priority dispute between the creditor and the CCC.[128]

A bankruptcy court in Wisconsin reached a similar conclusion allowing the CCC to set off over $20,000 in 1984 deficiency payments owed to a farm debtor against a separate obligation in excess of that amount due from the debtor to the CCC, for unpaid 1982 and 1983 corn storage loans.[129] The court ruled that the claims were mutual obligations and that to allow set-off would not result in an improvement in position by the creditor and would not be treated as a voidable preference under the Bankruptcy Code.[130] The debtor had argued that the transfer of the claim from the ASCS to the CCC during the ninety-day pre-petition period constituted a transfer under § 553(a)(2), but the court rejected the theory and held that for purposes of the Bankruptcy Code, the obligations were always the obligation of the CCC, irrespective of the role of the ASCS. The third issue raised in the case concerned a claim that under § 553(a)(3), the debt was incurred within the ninety-day pre-filing period while the debtor was insolvent and for the purposes of establishing a right of set-off. The court rejected the theory in this case, but the case does illustrate the use of the language of § 553 to attempt to avoid set-offs.[131]

Debtors in several cases have been successful in resisting agency attempts to offset farm program payments. In a 1987 decision, the United States Bankruptcy Court for South Dakota ruled that the SBA could not offset a pre-petition claim against the debtor's ASCS payments because there was no mutuality of obligation as required under § 553.[132] The court reasoned that the ASCS, not the SBA, owed the debtor money. Thus, the debts were not between the same parties standing in the same capacity because, while both

it acknowledged having subordinated its claims to the banks. If such a subordination were not present, the result could have been different.

127. *See* In re Wuchter, No. 85-00700D, slip op. (Bankr. N.D. Iowa July 11, 1986).

128. *Id.* at 9.

129. In re Brooks Farm, 70 Bankr. 368 (Bankr. E.D. Wis. 1987).

130. *Id.* at 372.

131. *Id. See also* Matter of Hafner, 25 Bankr. 882 (Bankr. N.D. Ind. 1982).

132. In re Rinehart, 76 Bankr. 746 (Bankr. D.S.D. 1987).

agencies were part of the government, they are not the same for purposes of § 553.[133]

A bankruptcy court in Michigan reached the same result, that CCC would not be allowed to offset 1985 storage loans against 1985 deficiency payments, but for a different reason. In *In re Walat Farms, Inc.*,[134] the court concluded that because a farmer must perform a number of duties, such as not to plant a certain acreage of crops, after signing a contract to participate in ASCS price support programs, such a contract was an executory contract.[135] Under this reading, if the contract was properly assumed by the debtor in possession in bankruptcy, then any right to receive payments would be considered as post-petition. Thus, mutuality would not exist and set-off would be disallowed.[136] The cases demonstrate that while set-off is available for the use of creditors, particularly governmental creditors, any attempt to do so may face arguments that such set-off is not proper under applicable federal law.

The newest development concerning the issue of administrative set-off concerns actions by the FmHA to obtain federal farm program payments which are owed to delinquent borrowers. The agency promulgated rules for such actions in November of 1986,[137] but public outcry to set-off activities in early 1987[138] and other FmHA litigation may limit the agency's use of the procedure. There are a number of reported cases from Texas in which courts have recognized the ability of the FmHA to achieve such set-offs, holding that the contract rights to receive ASCS deficiency payments attached at the time of signing the participation contract.[139]

A thorough discussion of the legal issues raised by the FmHA's use of administrative offset to collect the farm program benefits of delinquent borrowers directly from the USDA is beyond the scope of this article. There do appear to be very serious procedural and constitutional problems with the practice and the manner in which it is utilized. In October 1987, Sarah Vogel of the North Dakota Attorney General's Office prepared an extensive thirty-page legal memorandum which identified and discussed the authority for FmHA action and the conflicts between the procedure and the Federal Debt Collection Act of 1982, the USDA rules for offset, and the current national class action litigation involving the FmHA and its debt enforcement procedures. It is likely that the numerous statutory and constitutional challenges identified in that memo will be raised in future litigation challenging FmHA offset actions.

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133. *Id.* at 753-54.

134. 69 Bankr. 529 (Bankr. E.D. Mich. 1987).

135. *Id.* at 531.

136. *Id.*

137. 51 Fed. Reg. 42820 (1986), implementing 7 C.F.R. Part 1951.

138. *See* Miller, *FmHA Confiscating Subsidy Payments*, IOWA FARMER TODAY 1 (Apr. 25, 1987) (banner headline). *See also supra* note 119.

139. *See, e.g.*, In re Parrish, 75 Bankr. 14 (Bankr. N.D. Tex. 1987); Waldron v. FmHA, 75 Bankr. 25 (Bankr. N.D. Tex. 1987); In re Pinkert, 75 Bankr. 218 (Bankr. N.D. Tex. 1987); In re Buske, 75 Bankr. 213 (Bankr. N.D. Tex. 1987).

THE EFFECT OF CCC LIEN WAIVER FOR PRICE SUPPORT LOANS ON CREDITORS' CLAIMS TO DEBTORS' CROPS

A legal issue related to the use of farm program benefits, which may become a potential concern to lenders is the effect of signing a lien waiver on a debtor's crop for purposes of placing the commodity in a government nonrecourse price support loan program. The government requires such a waiver as a condition of making such loans to insure that the debtor has clear title in the commodity given to the government as collateral for the loan. The form, CCC-679, "Lien Waiver," used by the USDA provides:

> The undersigned holder of a lien on the above described commodity does hereby waive, relinquish and surrender all right, title and interest in and to said commodity in order that the producer may obtain a loan upon the security thereof, or sell the commodity to the Commodity Credit Corporation under the price support program. . . .[140]

The lienholder is then given the option of choosing between authorizing "the payment to the producer (debtor) or persons designed by him/her of the proceeds of such loan or sale," or authorizing "the loan proceeds to be disbursed jointly to the producer and the undersigned lienholder." If the lienholder chooses the option of joint payment, the opportunity exists to satisfy part or all of the indebtedness out of the proceeds of payment. If they choose the first option, this may not be the case. The main legal issue that could arise from signing the waiver is the effect of the waiver on the creditor's ability to claim an interest in the commodities or their proceeds.

The issue has been addressed by the courts on only two occasions and in both cases, the courts held that the waiver relinquished all claims by the creditor, thereby preventing it from claiming an interest in the goods. In *In re Bar C Cross Farms and Ranches, Inc.*,[141] the debtor was claiming sole possession of $74,130.76 which represented the proceeds from the sale of a wheat crop.[142] The PCA which financed the crop and took a security interest in it also waived its lien for purposes of price support loans. Nonetheless, it claimed the sale proceeds. The PCA argued that the waiver served only to subordinate its secured claim to the lien of the federal government and did not constitute a release of its security interest. The court rejected the PCA's subordination claim, noting that the plain language of the agreement was clear, it was a waiver, not a limited subordination. The court also rejected the theory that even in light of the waiver, the after acquired property clause would work to reattach to proceeds once received.[143]

In *Iowa Trust and Savings Bank v. U.S. Dep't of Agriculture*,[144] the bank signed a waiver allowing the debtor to place the 1981 corn crop into the loan program, opting for the joint payment provision. In late 1981 and early 1982,

140. CCC-679 Lien Waiver, 9-30-77.
141. 48 Bankr. 976 (D. Colo. 1985).
142. *Id.* at 979.
143. *Id.*
144. 42 U.C.C. REP. SERV. (CALLAGHAN) 1471 (N.D. Iowa 1986).

the CCC loaned the debtors over $43,000 on the crop. In November 1983, the debtors sold the crop for $28,142.64 without the authorization of either the creditor or the government. The bank obtained deficiency judgments of over $120,000 against the debtor and attempted to claim $20,161.60 in proceeds from the 1981 crop sale which were held on deposit. The government was also claiming the entire amount to satisfy the unrepaid loan.[145]

The bank raised two theories: (1) that the waiver was effective only as to a claim to the physical grain, not to any proceeds received from the disposal of the grain; and (2) that even if the bank no longer had a security interest in the proceeds, it was a judgment creditor and had priority over the government's unperfected security interest. The court rejected the theory that the waiver was limited, citing *In re Bar C Cross Farms and Ranches, Inc.* for the proposition that the waiver form means that "absolutely no right, title, or interest remain."[146] The court noted that the purpose and effect of the lien waiver were set out in the CCC regulation, which provided:

> If there are any liens or encumbrances on the commodity, waivers that fully protect the interest of the CCC must be obtained even though the liens or encumbrances are satisfied from the loan or purchase proceeds. . . . No additional liens or encumbrances shall be placed on the commodity after the loan is approved.[147]

The court ruled that after considering the plain language of the lien waiver and the purposes for which it was obtained, the bank "waived its security interest in both the commodity and the proceeds."[148]

On the second issue, the priority of the bank's judgment lien to the government's unperfected lien in the proceeds based on the loan, the court rejected the bank's claim. It reached this result from a combination of factors including, the bank's knowledge of the government's claim, the terms of the waiver, and the fact that the bank had already received some return on the 1981 corn loan because the CCC loan proceeds were paid jointly to the debtor and the creditor.[149]

CONSERVATION RESERVE PROGRAM PAYMENTS AND CREDITOR CLAIMS

One of the most significant new federal farm programs which will funnel billions of dollars into the U.S. agricultural community is the long term Conservation Reserve Program (CRP).[150] The goal of the CRP is to retire forty-five million acres of marginal cropland from production for ten years. Under this program, eligible landowners bid to retire erodible cropland from production. Participants receive cost-sharing money to establish conservation prac-

145. *Id.* at 1472.
146. *Id.* at 1473-74.
147. *Id.* at 1474 (citing 7 C.F.R. § 1421.10).
148. *Id.* at 1474-75.
149. *Id.* at 1475.
150. FOOD SECURITY ACT OF 1985, PUB. L. NO. 99-198, §§ 1201, 1231-1244, 99 Stat. 1354 (1985); 16 U.S.C.A. §§ 3801, 3831-3844 (West Supp. 1987); 7 C.F.R. Part 704 (1987).

tices, annual rental payments for retiring the land, and in 1987, some participants received a one-time bonus payment for reduction of base acres eligible for other price support programs.

The central legal issue concerning payments made under the CRP will be the classification and treatment of such payments, particularly the annual rental payments. If the CRP payments are treated similarly to most other farm program benefits, they will be a form of personal property, reachable under the U.C.C. The question of whether they are in fact subject to a security interest will depend on the language of the security agreement and the court's classification of the payments as proceeds of a crop or general intangibles, or as "rents and profits" of the land under a mortgage.

In the one reported case which dealt with a creditor's claim to conservation payments, a bankruptcy court in Oregon held that a creditor did not have a security interest in either the CRP payments or the conservation cost-sharing payments made under the Agricultural Conservation Program (ACP).[151] The court reasoned the debtor had entered the programs post-petition, and under § 552 of the Bankruptcy Code, the payments were not within the scope of the creditor's pre-petition security interest.[152] The court additionally held that ACP payments were not subject to the creditor's limited security interest covering "proceeds" since the payments were for conservation practices which are not a crop. The payments were, therefore, not the proceeds of a set-aside program.[153] The court did not specifically address the issue of whether the CRP payments were "rents" rather than personal property, but the analysis that the security agreement did not reach the payments as a result of post-petition issues intimates that the court would have treated the CRP payments like payments received from any other set-aside program but for the post-petition issue.

In an unreported Iowa district court opinion, a judge specifically addressed the issue of CRP payments as rent.[154] The case involved a claim by a receiver appointed pursuant to a mortgage foreclosure that CRP payments were the property of the receivership under a "rents and profits" clause in the mortgage. The court disagreed, holding that "CRP payments distributed in the form of PIK certificates are not rents or profits of the land enrolled in the program" but are "better classified as proceeds of a general intangible or as personal property of the producer."[155] The court went on to hold that even if such payments were classified as rents and profits, they could only be subject to a collection by a receiver as a matter of federal law in the event there had been a valid assignment of the payments to the receivership under the rules for assignment of payments and generic certificates.[156]

151. In re Sumner, 69 Bankr. 758 (Bankr. D. Or. 1986).
152. *Id.* at 764.
153. *Id.*
154. Nat. Bank & Trust Co. v. Relph, No. 20620, slip op. (Dist. Ct. Iowa Oct. 13, 1987).
155. *Id.* (citing In re Sunberg, 35 Bankr. 777 (Bankr. S.D. Iowa 1983), *aff'd*, 729 F.2d 561 (8th Cir. 1984) and Knosby v. First Iowa State Bank, 390 N.W.2d 605, 608 (Iowa App. 1986)).
156. *Id.*

It is important to note the special rules concerning assignment of CRP payments. These rules provide:

> [a]ny participant who may be entitled to any cash payment under this program may assign the right to receive such cash payment, in whole or in part, as provided in the regulations at 7 CFR Part 709, Assignment of Payment, except that assignments may also be made to secure or pay preexisting indebtedness.[157]

Two aspects of the rule deserve comment. First, assignments are restricted to the "cash" portion of CRP payments, thereby excluding payments made in the form of commodity certificates. Second, assignments are specifically allowed for preexisting indebtedness, which is not the case under the rules of 7 C.F.R. Part 709.[158]

The issue of CRP payments as "rents and profits" will undoubtedly be considered in future cases. While the CRP payments are perhaps most logically treated in the same manner as payments received under diversion or annual set-aside programs, the language of the statute authorizing the CRP provides some support for the "rents and profits" position.[159]

CONCLUSION

The discussion illustrates the economic importance of federal farm program payments to United States agricultural producers and their creditors. In an environment of financial stress with federal payments representing a larger share of available liquid assets, the process of securing creditor claims to farm program payments assumes a greater importance. The discussion has reviewed the various cases in which courts have taken sometimes conflicting views as to the legal treatment of such payments. While use of the assignment procedure available under ASCS rules offers creditors a direct, but not unlimited, method of securing claims to producer payments, legal questions exist. Inclusion of specific language covering federal farm program payments in the documents establishing the creditor's secured claim represents the most effective and perhaps more responsible method of securing such claims. Even given these actions, issues such as the application of post-petition property rules in bankruptcy proceedings and legal confusion over ASCS efforts to shield generic commodity certificates from state commercial law, mean that uncertainty will continue to surround the treatment of creditor claims. A greater appreciation of the nature and role of federal farm program payments by all parties—producers, their creditors, attorneys and the courts—will be necessary to satisfactorily address the subject.

157. 7 C.F.R. § 704.18, issued at 52 Fed. Reg. 4273 (1987).
158. *See supra*, discussion of assignments at note 53 and accompanying text.
159. *See* 16 U.S.C. § 3834 (1982).