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Policies and Priorities**

by

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# The Secured Farm Creditor's Interest In Federal Price Supports: Policies and Priorities

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American farmers benefit from a dazzling array of government programs. Many of these programs are designed to raise artificially the prices farmers receive for certain farm commodities. The techniques vary among the programs, but all are designed to put money or some other asset into the farmer's hands, often as a substitute for crops which did not quite make it to market. Sometimes the government gives the money or other asset away; sometimes it conditions its largess on receipt of a specific claim in certain commodities.

The farmer's general financier, whether private lending institution or federal agency, has a stake in the farmer's entitlements under these programs. The recent economic recession has pushed many farmers into bankruptcy, and these entitlements are important assets which may be claimed by the trustee or by the government itself. This Article discusses the operation and policies of these programs and addresses whether, in light of these policies, the general financier or crop lender can reach the farmer's entitlements under the programs and, if so, whether he can keep them when the farmer files for bankruptcy.

Since the federal support programs are tied to farm commodities or crops, the special rules of Article Nine of the Uniform Commercial Code (Code or U.C.C.) pertaining to crop lending are relevant and will be discussed in part I. In part II,

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the history, operation and policies of the various support programs are discussed. Part III deals with the interesting question of whether a special federal priority rule ought to apply to resolve conflicting claims. Finally, in part IV, we analyze the priority disputes which arise when the farmer's creditors, the federal government, the bankruptcy trustee and other assorted characters all claim rights to the proceeds generated by these price support programs.

## I. THE SPECIAL TREATMENT OF CROP FINANCING UNDER ARTICLE NINE

Article Nine's treatment of crop financing (and all farm lending, for that matter) has always been somewhat schizophrenic. This malady stems from the Code's inability to choose between two fundamentally inconsistent views of the farmer. One view treats the farmer as the manager of a modern agribusiness, and recognizes that crops are essentially the farmer's inventory.<sup>1</sup> For the most part, Article Nine follows this view and applies to crop lending just as it does to other sorts of inventory financing. A farmer is free to offer as collateral the wealth represented by his crops, and the secured lender may protect itself under Article Nine's general scheme.<sup>2</sup>

The alternative view of the farmer is that of a grizzled old man in bib overalls and straw hat. To the extent it follows this view, Article Nine is loaded with special, often paternalistic, rules for farm collateral. This special treatment of farmers is not unique; indeed, much of agricultural law may be thought of as a series of exceptions to other rules.<sup>3</sup> But special treatment in one area does not of itself justify special treatment everywhere.

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<sup>1</sup> "[M]ost farm products would be the farmer's inventory if it were not for the Code's arbitrary classification of them as farm products." Coogan & Mays, *Crop Financing and Article 9: A Dialogue with Particular Emphasis on the Problems of Florida Citrus Crop Financing*, 1C SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE § 27.09 (P. Coogan, W. Hogan & D. Vagts eds. 1968). For a general discussion of the problems of taking security interests in crops, see Meyer, *Potential Problems Connected with the Use of "Crops" as Collateral for an Article 9 Security Interest*, 1981-82 AGRIC. L.J. 115.

<sup>2</sup> See, e.g., UNIF. COMMERCIAL CODE §§ 9-102 (scope and policy), 9-105(1)(b) ("goods" defined), 9-401 (filing requirements) (Official Text 1972) [hereinafter cited as U.C.C.]. All citations are to the 1972 Official Text unless otherwise noted.

<sup>3</sup> See I. J. JUERGENSMEYER & J. WADLEY, *AGRICULTURAL LAW* § 1.2 (1982).

In this Article we demonstrate that many of Article Nine's special rules are unjustified and that others create more problems than they solve.

Preliminarily, it is worth noting that Article Nine contains no definition of "crops." It is clear enough that the U.C.C. treats crops as goods, and not as real estate.<sup>4</sup> Although at common law so-called "fructus naturales," or "natural" crops like fruit and nursery stock, were often treated as real estate,<sup>5</sup> the Code abolishes any lingering distinction between types of crops.<sup>6</sup> To take a valid security interest in crops, the creditor must comply with Article Nine, not real estate law.<sup>7</sup>

There are four general areas in which Article Nine singles out crops for special treatment. These are (1) treatment of after-acquired property, (2) method of perfection, (3) treatment of ordinary course buyers, and (4) certain priority rules.

#### A. *After-acquired Crops*

At common law, a crop mortgage was invalid before planting.<sup>8</sup> This rule reflected the early treatment of all after-acquired property clauses.<sup>9</sup> In the early twentieth century, however, states began to enact legislation permitting mortgages on future crops as long as the crops were planted within a specified time from the date the crop mortgage was executed.<sup>10</sup> These provisions found their way into the 1958 and 1962 Official Texts of the Code as section 9-204(4)(a). Under this section, a farmer could not offer as collateral crops which did not "become such" within a year after the security agreement was signed.<sup>11</sup> According to

<sup>4</sup> See U.C.C. § 9-105(1)(h). See also U.C.C. § 2-105(1).

<sup>5</sup> See R. BROWN, *THE LAW OF PERSONAL PROPERTY* 588-89 (3d ed. 1975).

<sup>6</sup> See U.C.C. § 2-105 & comment 1. For a good definition of crops, see 2 G. GILMORE, *SECURITY INTERESTS IN PERSONAL PROPERTY* 863-64 (1965).

<sup>7</sup> See, e.g., *United States v. Newcomb*, 682 F.2d 758, 760-61 (8th Cir. 1982).

<sup>8</sup> See, e.g., *Butt v. Ellett*, 86 U.S. (19 Wall.) 544, 547 (1873); *Long v. Hines*, 19 P. 796, 797-98 (Kan. 1888); *Cole v. Kerr*, 26 N.W. 598, 599 (Neb. 1886).

<sup>9</sup> See generally Cohen & Gerber, *The After-Acquired Property Clause*, 87 U. PA. L. REV. 635 (1939) and cases cited therein.

<sup>10</sup> See, e.g., KAN. GEN. STAT. § 58-322 (1949) (repealed 1965 when the U.C.C. was enacted). See generally Note, *Mortgages on Future Crops as Security for Government Loans*, 47 YALE L.J. 98 (1937).

<sup>11</sup> U.C.C. § 9-204(4)(a) (1962) states: "No security interest attaches under an after-acquired property clause . . . to crops which become such more than one year after the security agreement is executed. . . ."

the drafters, this rule was intended "to protect a necessitous farmer from encumbering his crops for many years in the future."<sup>12</sup>

As originally conceived, these statutes were enabling, not restricting. As crop lending became more sophisticated, however, their effect was to inhibit the farmer's ability to obtain financing based on his future crops.<sup>13</sup> In its Code incarnation the rule was silly, since it could be bypassed easily by the simple but clumsy expedient of writing a new security agreement each year.<sup>14</sup> Besides, five-year filing was allowed even for crops.<sup>15</sup> Thus, long-term crop financing was still possible, and this one-year limitation served merely as a snare for the unwary lender.<sup>16</sup> Fortunately, this restriction was removed by the 1972 Official Text, which is now law in at least thirty-nine jurisdictions.<sup>17</sup> In the treatment of after-acquired collateral, at least, crop lending has finally caught up with ordinary inventory financing.

### B. *Method of Perfection*

Crops, at least while they are growing or otherwise in the farmer's possession, are classified as "farm products" under Article Nine's scheme of categorizing collateral.<sup>18</sup> While these categories serve several purposes, the most important is to distinguish among methods of perfection. Filing is the most common means of perfection, and this method is normally used when the collateral is farm products such as crops.<sup>19</sup> However, rather than requiring filing in a centralized location, as for

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<sup>12</sup> U.C.C. app. § 9-204 (reasons for 1972 change).

<sup>13</sup> See 2 G. GILMORE, *supra* note 6, at § 32.2.

<sup>14</sup> See, e.g., *United States v. Minster Farmers Coop. Exch., Inc.*, 430 F. Supp. 566, 570 (N.D. Ohio 1977).

<sup>15</sup> See *id.*; U.C.C. § 9-403(2) (1962).

<sup>16</sup> See 430 F. Supp. at 570; *In re Bentley*, 17 Bankr. 636, 638 (Bankr. N.D. Ala. 1982) (quoting 5A *Benders Commercial Code Service* ¶ 93.07 (1985)).

<sup>17</sup> See U.C.C. REP. SERV. (CALLAGHAN) state correlation tables. Kentucky has yet to adopt the 1972 amendments. See KY. REV. STAT. ANN. §§ 355.1-101 - 355.10-102 (Bobbs-Merrill 1972) [hereinafter cited as KRS].

<sup>18</sup> See U.C.C. § 9-109(3).

<sup>19</sup> See U.C.C. § 9-401. Filing is a permissible method of perfection for all types of collateral except money and instruments. See U.C.C. §§ 9-302(1), 9-304(1).

inventory, the Code lumps all farm-based collateral with consumer goods and requires local filing.<sup>20</sup>

One possible justification for this local filing requirement is the drafters' belief that transactions involving farmers and consumers were "of essentially local interest."<sup>21</sup> This treatment seems anachronistic, especially in light of the growing role of corporate agribusiness and the shrinking family farm.<sup>22</sup> The drafters thought "sound policy require[d] a state-wide filing system for all [other] transactions."<sup>23</sup> Today, it would seem that the same policy should apply to agricultural transactions. Kansas apparently believes so; it recently shifted from local to state-wide filing for all farm collateral.<sup>24</sup> This reflects a trend in both federal<sup>25</sup> and state<sup>26</sup> law to stop treating farmers like consumers.

A second possible justification for local filing in farm cases is that farm products like crops have an unavoidable connection with land, and land interests are always local.<sup>27</sup> On examination, however, this explanation is also unsound. First, not all farm products are connected with land — growing crops clearly are; harvested crops, cows, chickens, fertilizer, feed, milk and eggs clearly are not. Yet all these are within the category "farm

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<sup>20</sup> See U.C.C. § 9-401(1). Each alternative requires central filing for inventory; the second and third alternatives require local filing for farm collateral. Kentucky's filing scheme is unique; local filing is required in all cases, and there is no central filing unless the debtor is a nonresident and has no principal place of business in Kentucky. See KRS § 355.9-401(1) (Cum. Supp. 1982).

<sup>21</sup> U.C.C. § 9-401 comment 3.

<sup>22</sup> See Looney, *Introduction: Agricultural Law in Arkansas*, 37 ARK. L. REV. i (1984); Wadley, *Small Farms: The USDA, Rural Communities and Urban Pressures*, 21 WASHBURN L.J. 478 (1982).

<sup>23</sup> U.C.C. § 9-401 comment 4.

<sup>24</sup> See 1983 Kan. Sess. Laws, ch. 345, § 1 (Supp. 1983).

<sup>25</sup> See, e.g., the Truth in Lending Act (codified as amended at 15 U.S.C. §§ 1602(h), 1603(l) (1982) by removing agricultural transactions from its general scope). Federal preemption of state usury laws for business and agricultural loans is another indication. See Pub. L. No. 96-221, §§ 511-12, 94 Stat. 161 (1980) (now expired).

<sup>26</sup> At least five of the ten states which enacted some version of the Uniform Consumer Credit Code have, since 1980, removed agricultural transactions from the reach of this law. See 1981 Colo. Sess. Laws, 386, 388 (amending COLO. REV. STAT. §§ 5-2-104, 5-3-104); 1980 Iowa Acts, ch. 1156, §§ 17-20 (amending IOWA CODE § 537.1301); 1981 Kan. Sess. Laws, ch. 93, § 5 (amending KAN. STAT. ANN. § 16a-1-301); 1981 Me. Laws, ch. 243 (amending ME. REV. STAT. ANN. tit. 9-A, § 1-301); 1982 Okla. Sess. Laws, ch. 335 (amending OKLA. STAT. ANN. tit. 14A, §§ 2-104, 3-104).

<sup>27</sup> Real estate interests such as deeds and mortgages are recorded at the local level under most statutory schemes. See, e.g., KAN. STAT. ANN. § 58-2221 (1983).

products."<sup>28</sup> Second, it is not only farm products for which local filing is mandated. The rule also covers farm equipment, no matter how mobile, and proceeds, such as accounts or general intangibles, arising out of the sale of farm products.<sup>29</sup> These items appear to lack connection to the land which might justify local filing.

As noted, growing crops are connected to the land, and the Code requires reference to the land in the description of growing crops used as collateral.<sup>30</sup> But this description is merely to help identify specific crops as collateral; filings for growing crops are done in the personal property records,<sup>31</sup> not in the real estate records. This rule recognizes that crops are goods, not real estate. Filings for other land-based collateral such as fixtures and minerals, on the other hand, are specifically assigned to the real estate records, precisely because of the land connection.<sup>32</sup> It is notable that the drafters did not think growing crops are sufficiently land-based to include them with these other land-based items. Having decided to treat them as goods, it seems anomalous to require local filing.

All of this would be academic but for the confusion caused in cases where the collateral has multiple or shifting uses. The reporters are full of cases, often inconsistent, in which lenders lost their security (usually to the bankruptcy trustee) because they guessed wrong about the nature of the collateral and filed in the wrong place. For example, tractors were held in one case to be business equipment because the debtor was not a farmer.<sup>33</sup> In another case and under a different test, tractors were held to be farm equipment because they are normally used in farming operations.<sup>34</sup> The same problem exists in other farm contexts. Depending on the jurisdiction, cattle placed in a feed lot may

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<sup>28</sup> See U.C.C. § 9-109(3).

<sup>29</sup> See U.C.C. § 9-401(1)(a) second & third alternatives.

<sup>30</sup> This is true in the security agreement itself as well as the financing statement. See U.C.C. §§ 9-203(1)(a), 9-402(1).

<sup>31</sup> See U.C.C. § 9-401(1)(a) second & third alternatives.

<sup>32</sup> See U.C.C. § 9-401(1) all alternatives & comment 4.

<sup>33</sup> See *In re Lieby*, 1 U.C.C. Rep. Serv. (Callaghan) 428, 430-31 (E.D. Pa. 1962). See also *In re Butler*, 28 U.C.C. Rep. Serv. (Callaghan) 596, 598-99 (Bankr. E.D. Tenn. 1980).

<sup>34</sup> See *In re Burgess*, 30 Bankr. 364, 366 (Bankr. W.D. Okla. 1983). See also *Sequoia Mach., Inc. v. Jarrett*, 410 F.2d 1116, 1118 (9th Cir. 1969); *Citizens Nat'l Bank v. Sperry Rand Corp.*, 456 S.W.2d 273, 275 (Tex. Civ. App. 1970).

remain farm products or may become inventory.<sup>35</sup> Nursery and landscaping stock have been held to be inventory,<sup>36</sup> farm products,<sup>37</sup> or both.<sup>38</sup>

Classification is obviously difficult. Treatise writers may suggest tests,<sup>39</sup> but these tests are helpful only if the lenders read them before they lend and, since the treatises disagree, only if the courts read the same treatises. A statutory filing scheme should not force a creditor to classify at his peril. The wise lender can solve the problem by filing everywhere, but this solution is unnecessarily expensive and cumbersome. The way to resolve the classification dilemma is either to abolish "farm products" as a separate category of collateral or to adopt the same filing scheme for all types of collateral.

### C. *Ordinary Course Buyers*

A third area reflecting Article Nine's confused paternalism toward farmers is the treatment of ordinary course buyers of farm products. In inventory cases, Code section 9-307(1) protects ordinary course buyers by cutting off the rights of secured creditors under any security interest created by the seller. Farm products, however, are an exception and the result is that farmers often cannot transfer good title to their crops.<sup>40</sup> This is a long standing rule; pre-Code cases nearly universally recognized the priority of the crop lender over the buyer, normally on the

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<sup>35</sup> Compare *Swift & Co. v. Jamestown Nat'l Bank*, 426 F.2d 1099, 1102 (8th Cir. 1970) (farm products) with *Garden City Prod. Credit Ass'n v. International Cattle Sys.*, 32 U.C.C. Rep. Serv. (Callaghan) 1207, 1209-10 (D. Kan. 1981) (inventory).

<sup>36</sup> See *In re Heil's Nursery, Inc.*, [Transfer Binder] SECURED TRANSACTIONS GUIDE (CCH) ¶ 52,687 (Bankr. S.D. Fla. 1975).

<sup>37</sup> See *In re Houts*, 31 U.C.C. Rep. Serv. (Callaghan) 338, 344 (N.D.N.Y. 1981).

<sup>38</sup> See *In re Frazier*, 16 Bankr. 674, 681 (Bankr. M.D. Tenn. 1981).

<sup>39</sup> See, e.g., B. CLARK, *THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE* ¶ 8.3[1][a] (1980) (suggesting, in equipment cases, that the courts "focus on the occupational status of the debtor rather than the normal use of the equipment"); J. WHITE & R. SUMMERS, *UNIFORM COMMERCIAL CODE* 944-45 (2d ed. 1980) (suggesting intended use rather than actual use should control).

<sup>40</sup> U.C.C. § 9-307(1) provides: "A buyer in ordinary course of business . . . other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence." See also *United States v. McClesky Mills, Inc.*, 409 F.2d 1216, 1218-19 (5th Cir. 1969) (buyer of peanut crop from farmer takes subject to FmHA's security interest); U.C.C. § 9-306(2).



theory that a filed chattel mortgage constituted constructive notice.<sup>41</sup> Article Nine, following these cases, etched this rule into statutory granite.

But why create special status for farm lenders? Gilmore questioned the original rule as one whose "reasons [were] never precisely articulated."<sup>42</sup> Other commentators have had similar reactions.<sup>43</sup> One could argue that normal buyers of raw farm products — people like auctioneers, warehousemen, processors, and the like — have less need for or are less deserving of this special protection than are normal buyers of inventory, namely consumers. But the general inventory rule protects all ordinary course buyers, not just consumers.<sup>44</sup> An additional problem is created by the possibility that the farm products exception could go on without end.<sup>45</sup> The ultimate purchaser of a farm product, therefore, might well be a consumer. This consumer would not be helped, even if the ex-farm product had become inventory by the time she bought it, because section 9-307(1) cuts off prior inventory interests only when they were created by the buyer's immediate seller.<sup>46</sup> Here, the original security interest was created long ago by the farmer. It seems that no sale of goods which were once farm products to anyone will ever cut off the farmer's secured creditor. This bizarre rule often thwarts market expectations and is, therefore, hard to justify.<sup>47</sup>

Even the Code drafters were not impressed with this rule. While considering the 1972 revisions, they "seriously questioned whether the pre-Code practice is still sound under modern conditions."<sup>48</sup> However, the drafters were also well aware that the federal government had become an important, perhaps the most important, farm lender. Indeed, nearly all of the reported cases

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<sup>41</sup> For a collection of cases see Annot., 77 A.L.R. 572 (1932).

<sup>42</sup> 2 G. GILMORE, *supra* note 6, at 707.

<sup>43</sup> See, e.g., Note, *Security Interests in Growing and Future-Growing Crops under the Uniform Commercial Code*, 49 IOWA L. REV. 1269, 1286-87 (1964) ("the rationale for this preferential treatment is not clear").

<sup>44</sup> See U.C.C. § 9-307(1).

<sup>45</sup> The security interest can be cut off by failure to refile if crops leave the state. See U.C.C. § 9-103(1). See also *In re Coast Trading Co.*, 31 Bankr. 670, 673 (Bankr. D. Or. 1983).

<sup>46</sup> See note 40 *supra*.

<sup>47</sup> See A. SCHWARTZ & R. SCOTT, *COMMERCIAL TRANSACTIONS, PRINCIPLES AND POLICIES* 601-02 (1982).

<sup>48</sup> U.C.C. app. ¶ B-9.

dealing with crop buyers under section 9-307(1) involve some federal agency, usually the Farmers Home Administration (FmHA).<sup>49</sup> The Article Nine revisors were concerned that a change in this section would lead to enactment of a special federal rule or to widespread, nonuniform amendments by the states.<sup>50</sup> As a result, the drafters left the rule alone in the 1972 revisions, and it remains part of the Code nearly everywhere.<sup>51</sup>

#### D. Priority Rules

A final area of special treatment for crops involves Article Nine's priority rules. In general, crops and other farm products are treated like most other collateral for priority purposes. A security interest, even in crops, is generally good against the whole world.<sup>52</sup> In addition, unperfected security interests lose out to certain lien creditors<sup>53</sup> and to other earlier perfected security interests.<sup>54</sup> But, as one might by now expect, there are some special rules.

Article Nine gives special status to most purchase money security interests.<sup>55</sup> For example, a purchase money security interest in inventory has priority over previously filed security interests in the same inventory, as long as certain conditions on timing and notice are met.<sup>56</sup> Since crops are not "inventory,"<sup>57</sup> however, crop lenders do not qualify for this protection.

Section 9-312(4) gives a similar purchase money priority to all "collateral other than inventory," but it is also doubtful that

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<sup>49</sup> See, e.g., *United States v. McClesky Mills, Inc.*, 409 F.2d 1216 (5th Cir. 1969); *United States v. Busing*, 7 U.C.C. Rep. Serv. (Callaghan) 1120 (E.D. Ill. 1970); *United States v. Hughes*, 340 F. Supp. 539 (N.D. Miss. 1972); *United States v. Smith*, 22 U.C.C. Rep. Serv. (Callaghan) 502 (N.D. Miss. 1972).

<sup>50</sup> See U.C.C. app. ¶ B-9.

<sup>51</sup> Kentucky has taken a few steps toward protecting the crop buyer by cutting off security interests in certain tobacco, livestock and racehorses sold at public auction and in grain and soybeans sold to certain warehouses, unless the secured party gives appropriate written notice. See KRS § 335.9-307 (Cum. Supp. 1982). Cf. N.D. CENT. CODE § 41-09-28 (1983) (U.C.C. § 9-307).

<sup>52</sup> See U.C.C. § 9-201.

<sup>53</sup> See U.C.C. § 9-301(1).

<sup>54</sup> See U.C.C. § 9-312(5).

<sup>55</sup> See, e.g., G. OSBORNE, G. NELSON & D. WHITMAN, *REAL ESTATE FINANCE LAW* 573-78 (1979) (discussing purchase money mortgages). See also U.C.C. § 9-107.

<sup>56</sup> See U.C.C. § 9-312(3).

<sup>57</sup> See U.C.C. § 9-109(3)-(4).

crop lenders qualify under this provision. For one thing, it is difficult to picture a purchase money interest in a farmer's crops. Production loans, for example, are not used for acquisition of the collateral. In the crop setting, this type of loan is very similar to a purchase money loan, but, generally, it is not treated the same.<sup>58</sup> Perhaps a seed supplier who retained a security interest, or the mortgagee of an apple orchard, would qualify. No one seems to have ever argued the point.<sup>59</sup> Section 9-312(4), however, is available for noncrop farm products such as livestock.<sup>60</sup>

Another reason section 9-312(4) does not apply to crops is the existence of section 9-312(2), a special rule relating to crop production enabling loans. This provision probably grants whatever limited purchase-money-like protection there is in Article Nine for crop loans.<sup>61</sup> To qualify, the lender must meet three tests. First, it must give new value to enable crop production during the current production season.<sup>62</sup> This criterion is easily met with the production loans given to farmers. Second, the loan must have been made no earlier than three months before the crops were planted.<sup>63</sup> This criterion leaves most long-term financiers unprotected. Third, the production lender will only defeat a prior perfected security interest if the prior interest "secures obligations due more than six months before the crops become growing crops."<sup>64</sup> "Due" has been held to mean "past due," and as a result, the priority exists only as against those lenders whose loans have been in default for at least six months prior to planting.<sup>65</sup> This restriction narrows the priority so much

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<sup>58</sup> Gilmore, too, seems to distinguish between production loans and purchase money loans. See 2 G. GILMORE, *supra* note 6, at § 32.5.

<sup>59</sup> A quick scan of the U.C.C. Digest and a preliminary search on LEXIS turned up no cases which discussed a purchase money security interest in crops, either under U.C.C. § 9-312(4) or elsewhere. In many states, however, statutory provisions will give priority for these and similar claims even over prior perfected Article 9 interests. See, e.g., KAN. STAT. ANN. §§ 58-203 (threshing liens), 58-218 (seeding and baling), 58-220 (agister's liens).

<sup>60</sup> See, e.g., *United States v. Mid-States Sales Co.*, 336 F. Supp. 1099, 1102 (D. Neb. 1971). *But see In re Smith*, 29 Bankr. 690, 694 (Bankr. W.D. Mo. 1983) (purchase money priority does not extend to calves).

<sup>61</sup> See 2 G. GILMORE, *supra* note 6, at 869 n.4.

<sup>62</sup> See U.C.C. § 9-312(2).

<sup>63</sup> See U.C.C. § 9-312(1).

<sup>64</sup> U.C.C. § 9-312(2).

<sup>65</sup> See *In re Connor*, 733 F.2d 523, 525-26 (8th Cir. 1984); *United States v. Minster Farmers Coop. Exch.*, 430 F. Supp. 566, 570 (N.D. Ohio 1977).

that it is rendered almost nonexistent.<sup>66</sup> In one reported Kentucky case,<sup>67</sup> the production lender was able to state facts which seemed to qualify it under section 9-312(2). The lender lost, however, because it filed in the wrong place.

In considering the 1972 revisions, the drafters appeared to want to change this provision to correspond in some way to the change in the after-acquired property rule of section 9-204.<sup>68</sup> In the end they failed to do so, although they recognized the section "is of little practical effect."<sup>69</sup> Gilmore predicted that section 9-312(2) would "take rank as one of the Code's dead letter provisions."<sup>70</sup> He was right. Crop lenders who want to protect themselves against earlier security interests in the same crop can do so only by getting subordination agreements,<sup>71</sup> a practice adhered to by the federal government.<sup>72</sup>

But what of Article Nine's treatment of the farmer's entitlements under the various price support programs? Before we can discuss this issue intelligently, we must describe the programs themselves and analyze the special federal interests at stake. In the next two sections of this Article we take up this task.

## II. THE HISTORY, VARIETY AND PURPOSE OF GOVERNMENT PRICE SUPPORTS

### A. *The Historic Need for Price Supports*

Price supports for agricultural commodities are not an exclusively American institution. Indeed, governments in virtually every major country in the world now attempt to influence the prices of at least some farm commodities.<sup>73</sup> Where intervention

<sup>66</sup> See 2 G. GILMORE, *supra* note 6, at 870.

<sup>67</sup> *United Tobacco Warehouse Co. v. Wells*, 490 S.W.2d 152 (Ky. 1973). This is the only reported case in which a secured creditor has even come close to complying with U.C.C. § 9-312(2).

<sup>68</sup> See U.C.C. app. ¶ B-7.

<sup>69</sup> *Id.*

<sup>70</sup> 2 G. GILMORE, *supra* note 6, at 870.

Subordination agreements are recognized in U.C.C. § 9-316.

<sup>71</sup> See text accompanying notes 214-17 *infra*.

<sup>72</sup> For example, in Australia, a grain marketing board pays farmers the difference between a board-determined price and the world price for that commodity. The European Community, on the other hand, pays exporters the difference between the support price, called the intervention price, and the exporter's sales price. In Canada, hog support prices are calculated on a five-year national average basis and a deficiency payment will

in pricing occurs, governments generally are attempting to achieve one or more of the following objectives: to raise farm-level prices and farm incomes; to more effectively allocate resources; to increase self-sufficiency in food and fiber; and to reduce price and income instability.<sup>74</sup>

In this regard, price support programs in the United States are no exception. For the most part, government programs here are primarily directed toward reducing price and income instability and toward raising the average level of farm prices and incomes.<sup>75</sup> These policy objectives predominate both as a result of economic conditions of the agricultural sector during the twenties and thirties and as a result of the way agriculture has been affected by market place supply and demand considerations.<sup>76</sup>

Historically, farming has been beset by so-called "boom and bust" cycles.<sup>77</sup> These cycles were essentially the result of factors totally beyond the farmer's control: predictions of record agricultural production drive prices down, consumer preferences for particular products shift, weather conditions affect the harvest, political factors remove lucrative markets, and so on. As a result,

be made to bring the current year price up to 90% of the long term average. In addition, each province may have an additional supplemental plan. For further discussion, see *Why the EC has to Subsidize Exports*, PROGRESSIVE FARMER 12 (Nov. 1982); *How Some Countries Subsidize*, PROGRESSIVE FARMER 13 (Apr. 1983). See also K. Campbell, *National Commodity Stabilization Scheme: Reflections Based on Australian Experience*, INTERNATIONAL EXPLORATIONS OF AGRICULTURAL ECONOMICS 55-63 (R. Dixey ed. 1964); C. Gilson, *How Much has the Canadian Wheat Board Cost Canadian Farmers?* 52 J. FARM ECON. 185-96 (1970).

<sup>74</sup> See, e.g., G. HALLETT, ECONOMICS OF AGRICULTURAL POLICY (1968); G. McCRONE, THE ECONOMICS OF SUBSIDIZING AGRICULTURE (1962); R. SCHICKELE, AGRICULTURAL POLICY: FARM PROGRAMS AND NATIONAL WELFARE (1954); G. SHEPHERD, AGRICULTURAL PRICE AND INCOME POLICY (1952); V. RUTTAN, AGRICULTURAL POLICY IN AN AFFLUENT SOCIETY (1969).

<sup>75</sup> See generally Scher, Catz & Mathews, *USDA: Agriculture at the Expense of Small Farmers and Farmworkers*, 7 TOLEDO L. REV. 837 (1976); Wadley, *Small Farms: the USDA, Rural Communities and Urban Pressures*, 21 WASHBURN L.J. 478 (1982).

<sup>76</sup> See, e.g., *Parker v. Brown*, 317 U.S. 341, 363-68 (1943); *Wickard v. Filburn*, 317 U.S. 111, 125-29 (1942); *Tigner v. Texas*, 310 U.S. 141, 145 (1940); *Fulford v. Forman*, 245 F.2d 145, 149-50 (5th Cir. 1957); *Usher v. United States*, 146 F.2d 369, 371 (4th Cir. 1944). See also W. RASMUSSEN & G. BAKER, PRICE SUPPORT AND ADJUSTMENT PROGRAMS FROM 1933 THROUGH 1978: A SHORT HISTORY IN ECONOMICS, STATISTICS AND COOPERATIVE SERVICE, USDA, AGRICULTURE INFORMATION BULLETIN No. 424 (1979).

<sup>77</sup> W. RASMUSSEN & G. BAKER, *supra* note 76; Harkin & Harkin, "Roosevelt to Reagan" *Commodity Programs and the Agriculture and Food Act of 1981*, 31 DRAKE L. REV. 499 (1981-82).

farmers are in a perpetual bind: when they have a good year and production is up, prices are low; when they have a bad year, prices are up but supplies are low.

During the 1920s and 1930s the cycle hit an unprecedented bust. Conditions in the agricultural sector have been described as "the worst economic-social-political wrenching in history."<sup>78</sup> By 1932, net farm income was less than one-third of what it had been in 1929 and farm prices had dropped more than fifty percent.<sup>79</sup> Prior to this disaster, a number of proposals had been presented to Congress in an attempt to moderate the effects of the "boom and bust" cycles.<sup>80</sup> Although none of these proposals were adopted, they did serve as a rallying point for those who felt the government should assume a responsibility for farm prices.<sup>81</sup> Perhaps the most widely supported of these proposals, known as the McNary-Haugen Plan,<sup>82</sup> was introduced in Congress in 1924 by Senator Charles L. McNary of Oregon and Representative Gilbert N. Haugen of Iowa. This plan would have provided for the sale abroad of American farm surplus at world prices, with a distribution of operating costs and losses among growers through an equilization fee.<sup>83</sup> The plan would have applied to eight basic agricultural commodities: wheat, corn, cotton, wool, cattle, sheep, swine, and rice.<sup>84</sup> In 1926, economist Charles L. Stewart of Illinois advanced a proposal which called for the payment of a bounty on the export of farm products and for the issuance of negotiable instruments called debentures which could be used by importers in paying customs duties.<sup>85</sup> Advocates of this proposal thought farm prices would be raised by the extent of the bounty.<sup>86</sup> At about the same time, Senator Lynn J. Fraser of North Dakota introduced a plan calling for government guaranteed prices reflecting the cost of production plus a fair profit.<sup>87</sup> Under this proposal, the govern-

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<sup>78</sup> W. RASMUSSEN & G. BAKER, *supra* note 76, at 1.

<sup>79</sup> *See id.*

<sup>80</sup> *Id.*

<sup>81</sup> *See id.*

<sup>82</sup> *See id.* at 2.

<sup>83</sup> *See id.*

<sup>84</sup> *See id.*

<sup>85</sup> *See id.*

<sup>86</sup> *See id.*

<sup>87</sup> *See id.*

ment would have established a federal agricultural marketing board which would buy ninety percent of the amount of wheat, corn, and cotton deemed necessary for domestic consumption and then sell those products at cost of production plus a fair profit.<sup>88</sup> Finally, in 1929, a Federal Farm Board was established on the theory that, with federal aid, farm marketing organizations could control the problem of low farm prices by purchasing surplus farm production.<sup>89</sup>

By the early 1930s, two things were clear: if federal efforts to stem the disastrous decline in farm prices were to succeed, federal legislation had to be enacted, and efforts to support farm prices could be successful only to the extent that production could be affected by the legislation.<sup>90</sup> In 1932 the Federal Farm Board, in a special report to Congress, recommended legislation which would "provide an effective system for regulating acreage or quantity sold, or both."<sup>91</sup> The groundwork for production control had already been laid in a proposal developed in the mid-1920s which involved making allotments to each producer equivalent to his proportion of the total crop sold for domestic use. This "voluntary domestic allotment plan" was embodied in the first piece of federal farm price support legislation adopted in the 1930s.<sup>92</sup>

The Agricultural Adjustment Act of 1933<sup>93</sup> (1933 Act) was a Congressional attempt to stabilize the farm economy and to relieve the unprecedented economic hardship suffered by farmers as a result of the Depression. Section 1 of the 1933 Act declared:

The present acute economic emergency being in part the consequence of a severe and increasing disparity between the prices of agricultural and other commodities, which disparity has largely destroyed the purchasing power of farmers for industrial products, has broken down the orderly exchange of commodities, and has seriously impaired the agricultural assets supporting the national credit structure, it is hereby declared

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<sup>88</sup> *See id.*

<sup>89</sup> *See id.*

<sup>90</sup> *See generally* AGRICULTURAL STABILIZATION AND CONSERVATION SERVICE, USDA, WHY FARM PROGRAMS? (1979) [hereinafter cited as WHY FARM PROGRAMS?]; W. RASMUSSEN & G. BAKER, *supra* note 76; Harkin & Harkin, *supra* note 77.

<sup>91</sup> W. RASMUSSEN & G. BAKER, *supra* note 76, at 3.

<sup>92</sup> *Id.*

<sup>93</sup> Agriculture Adjustment Act of 1933, ch. 25, 48 Stat. 31.

that these conditions in the basic industry of agriculture have affected transactions in agricultural commodities with a national public interest, have burdened and obstructed the normal currents of commerce in such commodities, and render imperative the immediate enactment of Title I of this Act.<sup>94</sup>

As initially adopted, the 1933 Act gave the Secretary of Agriculture the authority

(1) to secure voluntary reduction of the acreage in basic crops through agreements with producers and the use of direct payments for participation in acreage control programs; (2) to regulate marketing through voluntary agreements with processors, associations of producers and other handlers of agricultural commodities or products; (3) to license processors, associations of producers and others handling agricultural commodities to eliminate unfair practices or charges; (4) to determine the necessity for and the rate of processing taxes; and (5) to use the proceeds of taxes and appropriate funds for the costs of adjustment of operations, for the expansion of markets and for the removal of agricultural surpluses.<sup>95</sup>

The United States Supreme Court, in *United States v. Butler*,<sup>96</sup> declared unconstitutional the processing and floor stock taxes established by the 1933 Act. Nevertheless, most of the Act was reenacted in the Agricultural Marketing Agreement Act of 1937 (1937 Act) with an explicit Congressional declaration that the Act was not intended to regulate production.<sup>97</sup> As reenacted, the Secretary of Agriculture was authorized to promulgate mar-

<sup>94</sup> Agriculture Adjustment Act of 1933, ch. 25, § 1, 48 Stat. 31.

<sup>95</sup> W. RASMUSSEN & G. BAKER, *supra* note 76, at 4.

<sup>96</sup> 297 U.S. 1 (1936).

<sup>97</sup> See Agricultural Marketing Agreement Act of 1937, ch. 296, 50 Stat. 246. Reenacted were the following sections: § 1 (relating to the declaration of emergency), currently codified at 7 U.S.C. § 601 (1976); § 2 (relating to declaration of policy), currently codified at 7 U.S.C. § 602 (1976); § 8a(5)-(9) (relating to violations and enforcement), currently codified at 7 U.S.C. § 608a(5)-(9) (1976); § 8b (relating to marketing agreements), currently codified at 7 U.S.C. § 608b (1976); § 8c (relating to orders), currently codified at 7 U.S.C. § 608c (1976 & Supp. III 1979); § 8d (relating to books and records), currently codified at 7 U.S.C. § 608d (1976); § 8e (relating to determination of base period), codified as reenacted at 7 U.S.C. § 608e (repealed 1948); § 10(a), (b)(2), (c), (f)-(i) (miscellaneous provisions), currently codified at 7 U.S.C. § 610(a), (b)(2), (c), (f)-(i) (1976); § 12(a), (c) (relating to appropriation and expenses), currently codified at 7 U.S.C. § 612(a), (c) (1976 & Supp. III 1979); § 14 (relating to separability), currently codified at 7 U.S.C. § 614 (1976).



keting orders, establish minimum class prices, and regulate milk handling in designated marketing areas.<sup>98</sup> In 1938, Congress adopted the Agricultural Adjustment Act of 1938<sup>99</sup> (1938 Act) which authorized mandatory price support loans on certain non-perishable commodities and continued the voluntary domestic allotment plan of the 1933 Act. The constitutionality of the 1938 Act was upheld in the landmark case of *Wickard v. Filburn*.<sup>100</sup> The 1938 Act and the 1937 Act (reenacting portions of the 1933 Act) have continued to constitute the statutory basis for most of the current major price stabilization and support programs in operation today.<sup>101</sup>

### *B. The Economic Need for Price Supports*

In its broadest and most basic form, the federal farm price programs have two objectives: to raise the basic level of farm incomes and to insure an abundance of food and fiber at reasonable cost.<sup>102</sup> It is notable that both objectives are inherently incompatible. In the case of agricultural commodities, where most of the price increases occur at intermediate stages because of the activities of handlers and processors, a rise or reduction in consumer prices will not always translate into a corresponding rise or reduction in farm income.<sup>103</sup> In such a situation, a policy to directly promote lower consumer prices would alone invariably do little to enhance, and would most likely depress, farm income. As a result, the cost reduction policy is combined with a farm income policy that tends to be expressed in one of two formats. First, certain programs are directed at the middle-man handler or processor in a way that guarantees a minimum sale price to the producer. This is done, for example, under market-

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<sup>98</sup> See Agricultural Marketing Agreement Act of 1937, ch. 296, 50 Stat. 246.

<sup>99</sup> Ch. 30, 52 Stat. 30 (1938).

<sup>100</sup> 317 U.S. 111 (1942).

<sup>101</sup> Several acts have been adopted since the 1930s which have refined or modified to some extent the basic program legislation. These include the Agricultural Act of 1949, 7 U.S.C. §§ 601-24 (1976); the National Wool Act of 1954, 7 U.S.C. §§ 608-24 (1976); the Agricultural Adjustment Act of 1980, Pub. L. No. 96-213, 94 Stat. 119; and the Agriculture and Food Act of 1981, Pub. L. No. 97-98, 96 Stat. 1213.

<sup>102</sup> See generally Wadley, *supra* note 75.

<sup>103</sup> See generally V. RUTTAN, *supra* note 74.

ing agreements and orders<sup>104</sup> or through the establishment of a minimum price that must be paid by the handler to the producer.<sup>105</sup> This price is determined on the basis of what would be a fair return to the farmer-producer rather than by relative supplies of the particular commodity or by consumer demand.<sup>106</sup> Second, there are programs designed to make up the difference between an expected market price and a higher fair return price.<sup>107</sup> This is exemplified by the popularly understood grain price support programs.<sup>108</sup> These approaches have the advantage of allowing for production levels that ensure low consumer prices while at the same time artificially bolstering farm income.

Price support programs promote both higher farm incomes and abundant food supplies by separating the income distribution (higher farm income) objectives of federal policy from the marketing (low consumer prices) objectives.<sup>109</sup> Deficiency payments are made when the market price fails to reach a specified target price level.<sup>110</sup> Farm incomes may be increased as a result of direct government income supplementation, while consumers are protected from a simultaneous proportionate price increase. Of equal importance, prices of export crops can be kept competitive in world markets despite assuring higher returns to farmer producers.<sup>111</sup> To be effective, however, the "support" (in this case "target") price must exceed the equilibrium price between

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<sup>104</sup> See, e.g., Agricultural Marketing Agreement Act of 1937, 7 U.S.C. §§ 601-674 (1982). See also *Tigner v. State of Texas*, 310 U.S. 141, 146-47 (1940); *United States v. Rock Royal Coop., Inc.*, 307 U.S. 533, 542-48 (1939).

<sup>105</sup> See, e.g., 7 U.S.C. § 608c (1982). For further discussion, see I J. JUERGENSMEYER & J. WADLEY, *supra* note 3, at 281-356.

<sup>106</sup> See *Bailey Farm Dairy Co. v. Anderson*, 157 F.2d 87, 90 (8th Cir.), *cert. denied*, 329 U.S. 788 (1946).

<sup>107</sup> See AGRICULTURAL STABILIZATION & CONSERVATION SERVICE, USDA, ASCS BACKGROUND INFORMATION NO. 1 (1976) [hereinafter cited as ASCS BACKGROUND INFO. NO. 1].

<sup>108</sup> See generally I AGRICULTURAL LAW 1-74 (J. Davidson ed. 1981); II HARL, AGRICULTURAL LAW §§ 91.04-.06 (1983); I J. JUERGENSMEYER & J. WADLEY, *supra* note 3, at 245-79.

<sup>109</sup> See generally V. RUTTAN, *supra* note 74.

<sup>110</sup> See I J. JUERGENSMEYER & J. WADLEY, *supra* note 3, at 279.

<sup>111</sup> If the support price is set too high, however, foreign producers are encouraged to undersell American farmers, which may actually eliminate foreign markets for American farm commodities.

supply and demand.<sup>112</sup> Any time such a payment is made, farmers will receive income they would not have had were only normal market forces at work.

From an economic point of view, the equilibrium point of a normal supply and demand curve for agricultural products generally will not generate a satisfactory level of income for the farmer producer.<sup>113</sup> Since the turn of the century, our country has experienced a period of rapid and staggering growth.<sup>114</sup> Primarily because the demand for manufactured goods and services has seemed to expand virtually without limit as incomes have grown, this growth has generated rising incomes for those who provide the resources by and through which this growth has occurred. However, although the growth of supply of agricultural products has kept pace with that in other sectors of the economy, demand for agricultural products has grown more slowly than that for manufactured goods and services. This has been achieved primarily through advancements in agricultural technology. As a result, it has become fairly commonplace for farmers to produce far more of certain kinds of agricultural

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<sup>112</sup> If the support price is set at or below the equilibrium point, then the equilibrium, rather than the support price, will prevail. Since the participation in the program is essentially voluntary on the part of the farmers, if the farmers do not participate it is unlikely that any effective control over their production could be asserted. Therefore, it is necessary that the support price be higher than equilibrium in order to induce participation.

<sup>113</sup> This is because demand for agricultural products has historically grown more slowly than for industrial products and services. On the other hand, supply has remarkably expanded due to technology, invention and innovation. The impact of the slower growth in demand relative to increasing supplies constantly depresses farm commodity prices. In addition there has been an incentive for resources to move out of agriculture and into nonagricultural production activities. This in turn has raised the cost to the farmer to keep those resources available for farm production use purposes.

<sup>114</sup> See, e.g., *Sustainable Agricultural Systems: Hearings Before the Subcomm. on Department Operations, Research, and Foreign Agriculture of the House Comm. on Agriculture*, 97th Cong., 2d Sess. 67 (1982) (statement of Kenneth Farrell) [hereinafter cited as *Sustainable Agricultural Systems*]. See also HALLETT & GRAHAM, *THE ECONOMICS OF AGRICULTURAL POLICY* (1968); Eckstein & Syrquin, *A Note on Fluctuations in Supply and Farmers' Income*, 53 AM. J. AGRIC. ECON. 331 (1971); R. Krishna, *Agricultural Price Policy and Economic Development*, in *AGRICULTURE DEVELOPMENT AND ECONOMIC GROWTH*, 497-540 (H.M. SOUTHWORTH & B.F. JOHNSTON, EDs. 1967); G. McCrone, *THE ECONOMICS OF SUBSIDISING AGRICULTURE* (1962); G. Shepherd, *Agricultural Price and Income Policy*, in *AGRICULTURAL PRICES* (2d ed. 1952); F. Waugh, *Does the Consumer Benefit from Price Instability?*, 58 Q.J. ECON. 602-14 (1944).

commodities than market demand requires or can absorb,<sup>115</sup> thereby driving prices downward. Farm policy makers are convinced, therefore, that if chronic low farm income is to be raised, prices for farm commodities must be artificially supported at a level above the equilibrium point established by the market forces of supply and demand.<sup>116</sup> This objective has generally been pursued through the combined impacts of (1) programs designed to pay directly to the farmer the difference between the equilibrium price and the higher, more acceptable price, (2) programs which are designed to induce the farmer to reduce his production so that supply more closely approximates demand, and (3) programs which are designed to remove farm commodities temporarily or permanently from the market place.

### *C. Types of Current Price Support Programs*

Since the early 1930s, a variety of different approaches has been used by the federal government to bolster farm prices. As the program is currently administered, three types of price supports may be identified. These include postharvest loans, direct commodity purchases and direct payments.

#### *1. Loans*

For commodities within the jurisdiction of the Agricultural Stabilization and Conservation Service (ASCS) — for example feed and food grains, oil seeds, oils, fibers,<sup>117</sup> manufactured

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<sup>115</sup> In many cases, the commodities most frequently overproduced are also commodities that store well for a protracted period. Thus, if demand does not equal supply in a given year, the surplus may be carried over to succeeding years, further compounding the problem.

<sup>116</sup> Debate over the proposed 1985 farm bill has indicated that many policy makers are becoming convinced that a substantial move toward a more market ordered farm economy is desirable. See "From Washington," Doane's Agricultural Report, Dec. 14, 1984.

As a result, much of the current proposal is designed to gradually phase out many of the programs which have been in place since the late 1930s. See *Special Report: The Administration's 1985 Farm Bill*, Doane's Agricultural Report (1985).

<sup>117</sup> Feed grains include corn, grain sorghum, barley and oats. Food grains include wheat, rye and rice. Oil seeds and oils include flax seed, cottonseed, soybeans, tung nuts and occasionally sunflowers. Fibers include wool, mohair, upland cotton and extra long staple cotton. See generally AGRICULTURAL STABILIZATION & CONSERVATION SERVICE, USDA, ASCS BACKGROUND INFO. NO. 1 (1975).

milk, honey, gum navel stores, tobacco, peanuts and dry edible beans — the primary price support mechanism is the postproduction loan.<sup>118</sup> Although administered by the ASCS, postproduction loans to producers are made through the Commodity Credit Corporation<sup>119</sup> (CCC) once the particular commodity is placed in an approved storage facility.<sup>120</sup> The amount of the loan is designed to reflect a price level which the Secretary of Agriculture or Congress has determined represents an acceptable return to the farmer.<sup>121</sup>

There are two basic loan programs: regular loans and reserve loans.<sup>122</sup> Regular loans are made at the national loan rate and are of nine months' duration.<sup>123</sup> These loans may be repaid by the farmer at any time prior to the final maturity date of the loan by paying to the CCC the outstanding principal plus any interest that has accrued.<sup>124</sup> This enables the farmer to dispose of his commodity during the loan period. Reserve loans, on the other hand, involve a somewhat different situation. Reserve loans are made to producers at generally the same rate as regular loans but are for a much longer period—generally three years.<sup>125</sup> This longer period is designed to keep the grain off the market until such time as normal market forces drive prices to or above a level at which the farmer will be deemed to receive a fair return for his product. Thus, in contrast to regular loans, farm-

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<sup>118</sup> See *id.* at 6.

<sup>119</sup> The Commodity Credit Corporation (CCC) was created by Exec. Order No. 6340. For a brief synopsis of the early legislative history of the Commodity Credit Corporation, see 1948 U.S. CODE CONG. & AD. NEWS 2138, 2141-47. See also the Commodity Credit Corp. Charter Act, 14 U.S.C. § 714 (1982). For general background, see I J. JUERGENSMEYER & J. WADLEY, *supra* note 3, at 253-64. For a discussion of the role of the CCC with respect to stored grain, see Hamilton & Looney, *Federal and State Regulation of Grain Warehouses and Grain Warehouse Bankruptcy*, 27 S.D.L. REV. 334 (1982). See also 11 HARL, *supra* note 108, at §§ 91.04-.06; 1 AGRICULTURAL LAW, *supra* note 108, at 1-74; AGRICULTURAL STABILIZATION AND CONSERVATION SERVICE, USDA, ASCS BACKGROUND INFOR. NO. 1 (Oct. 1975), ASCS BACKGROUND INFO. NO. 2 (Mar. 1976).

<sup>120</sup> See ASCS BACKGROUND INFO. NO. 4, at 3 (May 1976).

<sup>121</sup> See WHY FARM PROGRAMS?, *supra* note 90. See generally I J. JUERGENSMEYER & J. WADLEY, *supra* note 3, at 245-79.

<sup>122</sup> USDA ASCS COMMODITY FACT SHEET, WHEAT (1983) [hereinafter cited as FACT SHEET].

<sup>123</sup> See *id.*

<sup>124</sup> See *id.*

<sup>125</sup> See *id.*

ers are generally not free to dispose of their commodities during the loan period. However, when the average national market price reaches a particular level (currently 125% of the national loan rate) and remains there for a specified period (currently five days), the commodity is released from its reserve status and the farmer may sell the commodity and repay his loan.<sup>126</sup> If the national market price drops below the "release price," the unsold commodity will be returned to reserve status and kept off the market.<sup>127</sup> In addition, if the national average market price reaches and remains at a generally higher level, the loan may be called and the farmer will be forced to repay the loan.<sup>128</sup> If this occurs, the farmer is completely free to dispose of the commodity in the marketplace.

A notable feature of both of these loans is that they are nonrecourse in nature. That is, the producers are not personally obligated to bear the loss resulting from any decline in the market price below the national loan rate. For example, if at the end of the regular nine-month loan period the national market price for the commodity has not reached the national loan level, the CCC may take title to the commodity as full payment of the loan and interest charges. Similarly, if at the end of the reserve contract the market prices have not reached the "release" level, producers can deliver the commodity to the CCC and discharge their obligation in full.<sup>129</sup>

Both loan programs may work in combination. At the end of the regular loan period, if the market price does not exceed the loan price, the crop may be eligible for entry into the farmer-owned reserve program.<sup>130</sup> If at the end of the reserve period the market price still has not reached the release level, the grain may be forfeited to satisfy the loan.<sup>131</sup> It is thus possible for the commodity to be held off the market for a fairly protracted period and ultimately not even be sold by the farmer. In addition, if the grain, encumbered by a prior lien, is forfeited to the

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<sup>126</sup> See *id.*

<sup>127</sup> See *id.*

<sup>128</sup> See *id.*

<sup>129</sup> Adjustments for both quantity and quality may be made by the CCC at time of forfeiture. 1 J. JUERGENSMEYER & J. WADLEY, *supra* note 3, at 277.

<sup>130</sup> See FACT SHEET, *supra* note 122.

<sup>131</sup> See *id.*

CCC, it may not be available to the creditor in the event of a default.<sup>132</sup>

## 2. *Purchases*

Commodity purchases make up the second major price support mechanism. In most cases, the producer must apply at the ASCS county office for the option of selling a quantity of his commodity to the CCC.<sup>133</sup> In the case of grains, however, purchases will be made as a result of CCC agreements with the producer.<sup>134</sup> In other situations — for example, manufactured milk products — the CCC is obligated by law to purchase commodities in an effort to reduce supplies and thereby generate higher prices.<sup>135</sup> The price paid for the commodity is generally established by regulation, and the CCC will purchase, up to the maximum eligible under the program, whatever quantity a producer wishes to sell.<sup>136</sup> Purchases have served as a major price support mechanism for milk, honey and grains.<sup>137</sup> As in the case of loans, grain that is subject to prior security interests may be sold to the CCC.<sup>138</sup> This raises the issue as to whether the collateral may have been removed from the reach of the creditor. We discuss this issue in part IV, below.

## 3. *Direct payments*

With certain specific commodities, government price support is achieved through direct payments to individual producers.<sup>139</sup> For wool and mohair, direct payments may be made to the producer in amounts which, "in combination with producer marketing returns, are designed to bring the producer's total

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<sup>132</sup> The normal way this matter is resolved is through the use of subordination agreements. This situation is forced somewhat by the impact of the *United States v. Kimbell Foods Inc.* decision. See text accompanying notes 188-230 *infra*.

<sup>133</sup> I. J. JUERGENSMEYER & J. WADLEY, *supra* note 3, at 279.

<sup>134</sup> See *id.* at 278.

<sup>135</sup> See *id.* at 336.

<sup>136</sup> See *id.* at 279.

<sup>137</sup> See *id.*

<sup>138</sup> In most cases, the CCC will require a lien waiver from the prior lender before it will make the postharvest loan to the farmer and accept the grain as collateral. The CCC currently uses Form CCC-679.

<sup>139</sup> See I. J. JUERGENSMEYER & J. WADLEY, *supra* note 3, at 279.

return up to the intended support level.”<sup>140</sup> For milk, fruits, nuts and vegetables, the Secretary of Agriculture will establish a minimum price that handlers must pay to the producers by marketing agreement or marketing order. For some other commodities, a price may be paid to the farmer for certain kinds of losses.<sup>141</sup> Finally, for most feed and food grains, the method of support is through what is called deficiency payments.<sup>142</sup> These payments essentially make up the difference between the national average market price and a higher “target price” set by the Secretary of Agriculture.<sup>143</sup> The “target price” is seen as a price level which will assure the farmer a fair return for his product.<sup>144</sup> However, it is only when the national average market price received by farmers for the first five months of the marketing year falls below the established target price that deficiency payments may be made.<sup>145</sup> Deficiency payments are computed by multiplying the payment rate by the farm’s established yield by the number of acres planted for harvest.<sup>146</sup> This figure may then be multiplied by any applicable allocation factor.<sup>147</sup> These payments present a different kind of Article Nine question. With direct payments, the Article Nine issue is whether the creditor has any claim to this “extra” money and, if so, on what theory. This question is discussed below in part IV.

A current variation of the direct payment program is found in the Payment In Kind (PIK) program.<sup>148</sup> Here, the farmer is

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<sup>140</sup> *Id.*

<sup>141</sup> Indemnity payments may be made to dairy program participants for milk received from the market or for cows producing the milk, because of contamination by pesticides and other harmful substances. A similar program is available to beekeepers who, through no fault of their own, suffer pesticide losses to their hives. See AGRICULTURAL STABILIZATION & CONSERVATION SERVICE, USDA, ASCS BACKGROUND INFO. NO. 5, at 5 (Nov. 1979).

<sup>142</sup> See generally I J. JUERGENSMEYER & J. WADLEY, *supra* note 3, at 279.

<sup>143</sup> See generally *id.*

<sup>144</sup> See *id.* at 267.

<sup>145</sup> See *id.* at 279.

<sup>146</sup> See *id.*

<sup>147</sup> See *id.*

<sup>148</sup> The basic legislative authority for Payment in Kind (PIK) is the Agriculture and Food Act of 1981, the Omnibus Budget Reconciliation Act of 1982 and the Commodity Credit Corporation Charter Act. Nevertheless, the PIK program is not as new as might appear from all the publicity it has received. Indeed, this type of approach has been used to dispose of some surpluses since the 1930s. See *Staff Report: An Amazing Development*, PROGRESSIVE FARMER 15-16 (Feb. 1983). Arguably, the Secretary of Agriculture has long had the authority with or without congressional approval to implement such a program.



given a quantity of grain, already harvested and in storage, in exchange for not planting all or a portion of his present acreage.<sup>149</sup> As the program is currently structured, the farmer is required either to reduce his acreage base between ten and thirty percent in order to participate in the regular PIK program or to retire his entire acreage on a bid basis.<sup>150</sup> To participate, the farmer signs a contract which entitles him to a quantity of grain equal to eighty percent of his normal yield for corn, sorghum, cotton and rice or to ninety-five percent of his normal yield for winter and spring wheat.<sup>151</sup> In return, the farmer promises to reduce his acreage by the stipulated amount. The contract provides for liquidated damages if the farmer does not comply with his obligation. Payment under the program is in the form of a certificate, redeemable after the first day of the marketing year for the particular commodity. This certificate, however, has limited assignability. Once the farmer accepts ownership of the PIK grain, he becomes responsible for marketing that grain. The government will pay storage costs on the grain for five months, giving the farmer some time in which to make his marketing decisions. If the farmer had grain in a reserve or regular loan program, he receives those stocks back as PIK grain and the loan is liquidated. If the farmer does not have grain under a loan program, grain will be supplied from somewhere else. Although price support programs sometimes operate in tandem, in this case the farmer is not able to get a CCC loan or reserve loan on the PIK grain.<sup>152</sup> The principal Article Nine problem here is whether the secured creditor can claim an interest in the PIK grain. This issue, too, is discussed in part IV of this Article.

Creditors may view farmers as more attractive loan applicants because of these government support programs. However,

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<sup>149</sup> See generally J. Bickers, *Now A Chance to get Back in the Black*, PROGRESSIVE FARMER 17 (Mar. 1983); J. Suber, *PIK Effects Spread*, Kansas RFD; Topeka Capital-Journal, Apr. 8, 1983, at 9, col. 4.

<sup>150</sup> See AGRICULTURAL STABILIZATION AND CONSERVATION SERVICE, USDA, ASCS COMMODITY FACT SHEET: FEED GRAINS, SUMMARY OF 1983 SUPPORT PROGRAM AND RELATED INFORMATION (June 1983). The popularity of this program coupled with devastating weather conditions so extensively depleted government grain reserves that for 1984 the PIK program was not extended for feed grains.

<sup>151</sup> See *id.*

<sup>152</sup> See *id.*

two additional observations about price supports are helpful in analyzing such lending decisions.

First, unless a price support program is mandated by statute,<sup>153</sup> the Secretary of Agriculture has considerable discretion in determining or approving the amounts, terms and conditions of price support programs. Section 401(b) of title V of the Agricultural Act of 1949<sup>154</sup> identifies the factors that must be considered by the Secretary in determining whether a price support program should be implemented for a specific commodity. These factors include: (1) the supply of the commodity in relation to the demand; (2) the price levels at which other commodities are being supported and, in the case of feed grains, the feed values of each grain in relation to corn; (3) the availability of funds; (4) the perishability of the commodity; (5) the importance of the commodity to agriculture and the national economy; (6) the ability to dispose of stocks acquired through a price support operation; (7) the need to offset temporary losses of export markets; and (8) the ability and willingness of producers to keep supplies in line with demand. These same factors<sup>155</sup> must be considered by the Secretary in determining the level of support even in statutorily mandated programs.<sup>156</sup>

Second, Congress has established a specific support range or level for many, but not all, farm commodities.<sup>157</sup> For other commodities, it is the responsibility of the Secretary to determine the support rate.<sup>158</sup> Although legislation may establish a range within which support rates may be set, the Secretary is generally authorized to increase support levels where it is determined, after a public hearing, that increased support is necessary in order "to prevent or alleviate a shortage in the supply of any agricul-

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<sup>153</sup> The Agriculture Act of 1949, 7 U.S.C. §§ 1421-1449 (1982), requires price support for the following basic commodities: extra long staple cotton, peanuts, rice and tobacco; loans and purchases for wheat; loans for upland cotton; and payments (under certain conditions) for corn, wheat and upland cotton. Price support is also mandated for the following designated nonbasic commodities: tung nuts, honey, milk, barley, rye and grain sorghum. The National Wool Act of 1954, Pub. L. No. 690, 68 Stat. 910, requires price support for wool and mohair.

<sup>154</sup> See 7 U.S.C. § 1421b (1982).

<sup>155</sup> 7 U.S.C. § 1421b.

<sup>156</sup> 7 U.S.C. § 1421b.

<sup>157</sup> See, e.g., 7 U.S.C. § 1444 (1982) (cotton price support levels).

<sup>158</sup> See 7 U.S.C. § 1421(b) (1982).

tural commodity essential to the national welfare”<sup>159</sup> or “to increase or maintain the production of any agricultural commodity in the interest of national security.”<sup>160</sup> Adjustments in specific support levels may be made for differences such as grade, type, quality and location,<sup>161</sup> or may result from the approval of marketing quotas by producers of specific commodities.<sup>162</sup>

#### D. *Limited Nature of Price Supports*

To deal adequately with a creditor's expectation interest in the payments, it is necessary to understand some important limitations. It is a popular misconception that government price support programs result in “free money” or ensure a profit for all farmers. However, the support programs with which this Article is concerned affect commodities which account for approximately only one-half the cash receipts of farmers in the United States.<sup>163</sup> The prices of commodities which account for the remaining farm receipts are influenced to some extent by these price support programs but are not directly supported in the same fashion. Thus, despite the popular feeling that governmental price support programs constitute the entire national farm program, not every farmer is involved in or affected by these programs.

Not only do price support programs not include all farm commodities, but even where programs are established not every farmer producing that commodity will be covered by the program. The price support programs considered by this Article are essentially voluntary in nature, and the individual farmer may elect to participate or not.<sup>164</sup> Despite the false impressions created by the landmark case of *Wickard v. Filburn*,<sup>165</sup> in which a penalty imposed on a farmer for raising grain in excess of an

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<sup>159</sup> 7 U.S.C. § 1422 (1982).

<sup>160</sup> 7 U.S.C. § 1422.

<sup>161</sup> See 7 U.S.C. § 1423 (1982).

<sup>162</sup> See 7 U.S.C. § 1441 (1982).

<sup>163</sup> These commodities include wheat, corn, peanuts, rice, tobacco, wool and mohair, upland and extra long staple cotton, honey, barley, oats, rye, sorghums, manufactured milk, flax, soybeans, gum naval stores, sunflowers, sugarbeets, sugar cane and dry edible beans. See I J. JUERGENSMEYER & J. WADLEY, *supra* note 3, at 249.

<sup>164</sup> See *generally id.* at 245-79.

<sup>165</sup> 317 U.S. 111 (1942).

imposed quota was upheld by the Supreme Court, government price support programs are not mandatory in nature. On the contrary, while a farmer must meet certain criteria before he will be allowed to participate in price support programs,<sup>166</sup> the decision to participate is entirely voluntary. Typically, in order to qualify for participation, the farmer must agree to reduce or at least not expand his planted acreage or he must agree to keep a portion of his crop out of the market place for a period of time.<sup>167</sup> Therefore, it is clearly inaccurate to characterize price support programs as “free money” to the farmer.

Further, statutes authorize price support programs for many, but not all, farm commodities plagued by problems of overproduction. This Article focuses upon those programs popularly understood as price supports — namely, programs affecting only the following commodities: corn, peanuts, rice, tobacco, mohair, upland and extra long staple cotton, honey, barley, oats, rye, sorghums, milk and its products, flax, soybeans, gum navel stores, sunflowers, sugar beets and sugar cane. As noted above, this comprises only about half of current domestic farm production.<sup>168</sup>

Finally, Congress has established limits on the amount of price support money that may be received by an individual farmer.<sup>169</sup> This is significant because, in determining whether to establish a price support program, little or no direct consideration is given to whether current market price actually reflects true costs of production or the amount of money a farmer “needs.” In many cases, the cost of producing a commodity may well exceed the price that commodity would bring in the market place. Thus, even though the amount permitted an individual farmer may be substantial, it may not be enough to ensure that the farmer breaks even with respect to the production of certain commodity. Hence, price support programs do not guarantee a profit to farmers.

### *E. Eligibility for Price Support Payments*

Whether a specific farmer is entitled to payments is also a variable to consider in addressing creditor expectation. Eligibility

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<sup>166</sup> See I J. JUERGENSMEYER & J. WADLEY, *supra* note 3, at 273-76.

<sup>167</sup> See *id.*

<sup>168</sup> See *id.* at 245-75.

<sup>169</sup> See 7 C.F.R. pt. 795 (1984) (payment limitation). See also 7 U.S.C. §§ 1307-08 (1982).

for price support payments may be conditioned upon compliance with legislative requirements or upon conditions established by the Secretary.<sup>170</sup> In recent years, there has been a tendency to link participation in price support programs to participation in specific production adjustment programs. Where this occurs, one of several commonly used production adjustment programs will be implemented as part of the total price support program.<sup>171</sup> These programs are authorized by federal legislation<sup>172</sup> and include cropland set-aside programs, marketing quotas and paid diversions. Because of the nature of the criteria, the farmer is not always eligible to participate in these programs.

### 1. *Set-asides*

Set-aside programs<sup>173</sup> are essentially acreage reduction programs in which participating farmers withhold from production a number of acres—usually measured as a fraction of the acres normally planted for harvest. In addition, the farmer will generally be obligated to plant an approved cover vegetation or use an approved conservation practice on those idled acres to control wind and water erosion. Additionally, producers may be prohibited from offsetting reduced production on a participating farm by increasing production on a nonparticipating farm for crops covered by the set-aside provisions. As a general rule, participation in set-aside programs is voluntary and no direct compensation is paid to the farmer for not planting the idled acreage. To encourage farmers to participate, the set-aside requirement is generally designed so that the reduced acreage will result in reduced total production, which in turn will have a positive

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<sup>170</sup> See 1 J. JUERGENSMEYER & J. WADLEY, *supra* note 3, at 245-75.

<sup>171</sup> See *id.*

<sup>172</sup> See Agricultural Adjustment Act, 7 U.S.C. §§ 601-24 (1976); Price Supports of Agricultural Commodities, 7 U.S.C. §§ 1421-50 (1982). For further discussion, see 11 HARL, *supra* note 108, at §§ 91.04-.06; 1 J. JUERGENSMEYER & J. WADLEY, *supra* note 3, at 273-76.

<sup>173</sup> See, e.g., Agriculture and Food Act of 1981, tits. III & XI, Pub. L. Nos. 97-98, 95 Stat. 1213. See generally 1 J. JUERGENSMEYER & J. WADLEY, *supra* note 3, at 273-75; USDA LOAN, PURCHASE AND PAYMENT PROGRAMS, ASCS BACKGROUND INFO. NO. 5 (1979)[hereinafter cited as LPP PROGRAMS]; ECONOMIC RESEARCH SERVICE, USDA HISTORY OF AGRICULTURAL PRICE SUPPORT AND ADJUSTMENT PROGRAMS, 1933-84, BACKGROUND FOR 1985 FARM LEGISLATION, AGRICULTURAL INFO. BULLETIN NO. 485 (1984)[hereinafter cited as Economic Research Service].

impact by increasing commodity prices. As a result, lower direct payments will be required under the price support programs and higher farm incomes will be realized. Conceivably, a creditor could insist on participation as a prerequisite to the loan. However, mere participation does not guarantee a price support payment; it merely determines eligibility. Market forces will determine whether an actual payment is to be made.

### 2. *Paid Diversions*

A paid diversion program differs from a set-aside program in that farmers are induced to take acreage out of designated crop production in exchange for a direct payment.<sup>174</sup> In most cases, this payment will be calculated on the basis of the established farm yield multiplied by the acreage diverted and further multiplied by the payment per unit amount. Conceptually, the paid diversion program is designed to accomplish the same objectives as set-asides, though at greater cost to the government. As with set-asides, the farmer will generally be required to use the land idled under the program in an approved, noncrop-producing manner. An interesting question, discussed below, is whether the Article Nine lender could reach the diversion payment itself as additional collateral.

### 3. *Acreage Allotments*

With respect to certain commodities — such as extra long staple cotton, rice, peanuts and tobacco — the total desired annual production of the commodity has been divided among farmers on an individual basis predicated both upon the farm's past history of production of these crops and upon other factors.<sup>175</sup> Participation in the price support programs is further conditioned upon the producer's harvesting within the acreage allotments for the particular commodity set for his farm. This will artificially reduce the farmer's production and possibly reduce the size of the lender's expected collateral. As a result, the lender may wish that the farmer not participate in the program. Even if a specific program is not in force, or if the farmer elects

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<sup>174</sup> See I J. JURGENSMAYER & J. WADLEY, *supra* note 3, at 275-76.

<sup>175</sup> See *id.* at 276. See also LPP PROGRAMS, *supra* note 173.

not to participate, the farmer may still be required to confine production to his normal acreage for that commodity in order to maintain eligibility to participate in programs in future years.<sup>176</sup>

Thus, participation in government price support programs may require the farmer to give up some of his control over planting decisions. This suggests that, from the perspective of the government, it is more important that total national production be aligned with the demand for agricultural products than for individual farmers to realize higher incomes. It appears that this larger national interest would be jeopardized if farmers decide not to participate in the programs. This decision might occur if farmers see the farm lender, rather than themselves, as the primary beneficiary of the program (for example, where the lender is too readily given access to the support payments) or if they feel the lender is dictating their participation decisions.

#### *F. Characterization of Payments from the Perspective of Price Support Program Purposes and Objectives*

To determine creditor entitlement to price support payments, it is necessary to characterize the payments according to U.C.C. criteria. The treatment this characterization produces may or may not be consistent with price support policies. Thus, it may be helpful to understand whether — as a matter of price support (as opposed to U.C.C.) policy — supports are considered as a return for the disposition of the crop, as a substitute for a crop that would otherwise have been raised, or as something entirely distinct from the actual harvested crop.

There is a common perception that, because most so-called price support programs are frequently linked with production adjustment or acreage reduction requirements, the price support payment represents a return or substitute for the “lost” production. From a price support program perspective, however, this is often not the case. With CCC loans, the commodity is pledged as security for the loan, the amount of which is calculated in reference to an expected, above normal, market price.<sup>177</sup> If the market price actually reaches the loan level, a better than normal return will be assured in the sale by the farmer after the loan is

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<sup>176</sup> See 7 C.F.R. § 713.8, pt. 792 (1976).

<sup>177</sup> See ECONOMIC RESEARCH SERVICE, *supra* note 173.

paid off and the commodity redeemed. Alternatively, if the market does not reach the loan rate and the commodity is forfeited to the CCC to cancel the loan, the farmer has also been guaranteed a "profit" above that which normal market prices would guarantee. Thus, this support of farm income levels is consistent with both basic price support policy objectives: adequate supplies and a fair return. However, to accomplish this, no additional compensation is paid with respect to any unharvested or unplanted crops. The same is essentially true with reserve loans. Further, until it is determined whether the loan is to be repaid or the grain is to be forfeited, it is also impossible to say a "sale" has occurred so as to characterize the loan as compensation for the disposition of the crop.

Similarly, with deficiency payments, the amount paid to the farmer represents a differential between the established target prices and the higher of the national average market prices and the loan level.<sup>178</sup> The payments thus reflect actual sales only insofar as those sales have any bearing on average national market prices. The target prices are not calculated on a farmer-by-farmer basis; nor are the deficiency payments designed to make up the difference between the government established target price and what a particular farmer actually gets when the grain is sold. Payments to an individual farmer are, in a sense, based on the producer's share of the national program acreage rather than on his share of production or sales.<sup>179</sup> National program acreage, in turn, represents the number of harvested acres necessary to meet domestic and export needs<sup>180</sup> and to assure an acceptable level of carryover stocks. Again, payment is not made to reflect production loss due to out-of-production acres.

Incentive payments for wool and mohair are based on amounts needed to bring the average return received by all

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<sup>178</sup> See Economic Research Service, *supra* note 173; FACT SHEET, *supra* note 122.

<sup>179</sup> There is a \$50,000 cap on the amount of price support payments an individual farmer may receive. See 7 U.S.C. § 1308(1) (Supp. 1985). See also *Martin v. Bergland*, 639 F.2d 647 (10th Cir. 1981) (regulation considering husband and wife to be a single person for purposes of the payment limitation held not violative of equal protection or due process).

<sup>180</sup> See Agricultural Stabilization and Conservation Service, USDA ASCS Commodity Fact Sheet: Wheat (Summary of 1983 Support Program and Related Information) (June 1983); I J. JURGENSMAYER & J. WADLEY, *supra* note 3, at 273-279.



producers up to the support level.<sup>181</sup> With these commodities, because the relevant percentage is applied to the producer's net proceeds from sales, the producer who gets a higher sales price actually gets a higher total income. The incentive feature is seen as encouraging improvement in quality and marketing and clearly does not compensate for lost production.

Finally, in the case of direct purchases, it is clear that the government price paid is calculated on the basis of the actual quantity sold,<sup>182</sup> not on what the individual farmer might have sold had the entire acreage been planted. Although this payment represents income to the farmer and may be considered as property in his hands, it is not an exact substitute for crops that would otherwise have been raised nor is it necessarily, except for the direct purchase situation, part of the "return" for crops actually sold. On the other hand there are several programs which provide payments as a substitute for lost production. First, with disaster payments<sup>183</sup> (which are currently not a part of the farm price program) and crop insurance proceeds<sup>184</sup> (which are designed to replace the phased out disaster program), the payment does represent a return for a crop not harvested or planted. Similarly, an indemnity payment, which has been part of the dairy program, may be made to farmers for milk removed from the market (or for cows producing such milk) because of contamination with pesticides or other harmful substances.<sup>185</sup> Indemnity payments can also be made to beekeepers for similar losses.<sup>186</sup> In either case, the payment represents "lost" production.

When a paid diversion program is in effect, the farmer is induced through a direct payment to remove land from production. Because it is calculated and paid on a per bushel basis for the otherwise expected yield from the diverted acreage, this payment may be viewed as compensation for lost production.

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<sup>181</sup> See, e.g., Agricultural and Food Act of 1981 tit. II, Pub. L. No. 97-98, 95 Stat. 1213.

<sup>182</sup> See USDA ACQUISITION AND DISPOSAL OF FARM COMMODITIES BY CCC, ASCS BACKGROUND INFO. NO. 3 (1975). See also Agriculture and Food Act of 1981, §§ 503, 1103, Pub. L. No. 97-98, 95 Stat. 1213; 7 U.S.C. § 1427 (1982).

<sup>183</sup> See LPP PROGRAMS, *supra* note 173, at 4.

<sup>184</sup> See 7 U.S.C. §§ 1501-1520 (1970).

<sup>185</sup> LPP PROGRAMS, *supra* note 173, at 5.

<sup>186</sup> See *id.*

PIK payments are similar. There, instead of cash, the farmer is given a quantity of the commodity equivalent to that represented by the acreage not planted.

In these latter cases, the payment should be treated as the equivalent of a crop. From a property point of view, the farmer's interest in the payment should be treated as the equivalent of a profit or rent from the land. In determining whether the payments are to be treated as the equivalent of a crop for Article Nine purposes, however, courts rarely have made these distinctions and have instead treated them as crop substitutes or proceeds. The Article Nine framework, however, knows nothing of "rents and profits," and the proceeds approach may be necessary. Part IV discusses the problems courts have had sorting out proceeds issues.

### III. WHAT LAW APPLIES?—A LOOK BEYOND *United States v. Kimbell Foods, Inc.*

Until recently, there has been some uncertainty as to whether a government security interest—such as one arising from a FmHA loan or from a CCC price support loan — would prevail over private liens and, if so, whether priority would be determined on the basis of federal or state law.<sup>187</sup> The recent decision of *United States v. Kimbell Foods, Inc.*<sup>188</sup> is generally understood as permitting nondiscriminatory state law, such as Article Nine of the U.C.C. to be used in the absence of an applicable federal statute setting relevant priorities.<sup>189</sup> Several cases have applied Article Nine to the question of whether a perfected Article Nine security interest attaches to a farmer's interests in PIK grain.<sup>190</sup> However, a careful consideration of *Kimbell Foods* suggests that result may not be inevitable.

In *Kimbell Foods* the Court considered the relative priority of liens arising from federal — Small Business Administration

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<sup>187</sup> See, e.g., Comment, *The FmHA Security Interest: Are Remedies Divisible from Perfection and Priority?*, 24 S.D.L. REV. 753 (1979).

<sup>188</sup> 440 U.S. 715 (1979). *Kimbell Foods* was the consolidation of two cases. The first case addressed the priority of loans guaranteed by the Small Business Administration. The second case, styled below as *United States v. Crittenden Tractor Co.* addressed the same issue where the Farmer's Home Administration was the guarantor.

<sup>189</sup> See 440 U.S. at 740.

<sup>190</sup> For a discussion of these cases, see text beginning with note 326 *infra*.

(SBA) and FmHA — loan programs and private liens perfected under state versions of the U.C.C. In the case before the Court involving an SBA loan,<sup>191</sup> a private security interest was created prior to the creation of a federal lien.<sup>192</sup> After the federal loan was made, the private lender advanced additional money under a standard “dragnet” clause in the original agreement which provided that the collateral would secure future advances.<sup>193</sup> Both the federal and private security interests were perfected under the state U.C.C.<sup>194</sup> In the FmHA case<sup>195</sup> a government loan was secured by an interest in the borrower’s crop and farm equipment.<sup>196</sup> The competing private lien arose from the borrower’s nonpayment for subsequent repairs made on the borrower’s tractor and permitted the creditor to retain possession of the tractor.<sup>197</sup> In reviewing these cases, the Court specifically held that the priority of liens stemming from federal lending programs must be determined with reference to federal law.<sup>198</sup> However, where federal law does not specify the appropriate rules for decision and unless a uniform federal rule is required, nondiscriminatory state law is to be adopted as federal law.<sup>199</sup>

In reaching this conclusion, the Court dealt with two specific questions: whether the application of federal law is required, and what the content of federal law should be. With respect to the first question, the Court noted that federal law has consistently been held to govern “questions involving the rights of the United States arising under nationwide federal programs.”<sup>200</sup> The theory behind this position is that, “[s]ince the agencies derive their authority to [act] from specific Acts of Congress passed in the exercise of a ‘constitutional function or power,’ . . . their rights, as well, should derive from a federal source.”<sup>201</sup> Further,

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<sup>191</sup> See note 188 *supra*.

<sup>192</sup> See 440 U.S. at 718.

<sup>193</sup> See *id.* at 719.

<sup>194</sup> See *id.* at 718.

<sup>195</sup> See note 188 *supra*.

<sup>196</sup> See 440 U.S. at 723.

<sup>197</sup> See *id.*

<sup>198</sup> See *id.* at 726.

<sup>199</sup> See *id.* at 740.

<sup>200</sup> *Id.* at 726.

<sup>201</sup> *Id.* (quoting *Clearfield Trust Co. v. United States*, 318 U.S. 363, 366 (1943)) (citing *United States v. Seckinger*, 397 U.S. 203, 209-210 (1970); *United States v. Standard Oil Co.*, 332 U.S. 301, 305-06 (1947); *Sola Elec. Co. v. Jefferson Elec. Co.*, 317 U.S. 173, 176 (1942); *Board of County Comm’rs v. United States*, 308 U.S. 343, 349-50 (1939)).

where "Government activities 'aris[e] from and bea[r] heavily upon a federal . . . program,' the Constitution and Acts of Congress 'require otherwise than that state law govern of its own force.'"<sup>202</sup> Under this theory, state statutes or standards may be used only "when Congress has not spoken 'in an area comprising issues substantially related to an established program of government operation'"<sup>203</sup> and where such standards are required "to fill the interstices of the federal legislation."<sup>204</sup>

The Court was clearly more troubled by the content question. It is clear from the Court's holding that Congress has the authority to fashion special rules to protect the federal interest where it deems such rules are appropriate.<sup>205</sup> It is also clear that where Congress has not acted, nondiscriminatory state law may be applied as if it were the nationwide federal rule.<sup>206</sup> It is not clear from the Court's decision, however, that state law must be applied every time Congress is silent.<sup>207</sup> The Court specifically identified three factors which must be considered in determining whether state law may be applied or whether a special federal rule must be judicially fashioned to protect the federal interest: first, whether the federal programs are by their nature such that a nationally uniform body of controlling federal rules is required;<sup>208</sup> second, whether the application of state law would frustrate specific objectives of the federal programs;<sup>209</sup> and third, whether the application of a federal rule would disrupt commercial relationships predicated upon state law.<sup>210</sup> Measuring the Government's arguments against this criteria, the Court concluded that the state commercial code "furnishes convenient solutions in no way inconsistent with adequate protection of the federal interest."<sup>211</sup> Further the Court noted that incorporating state law to determine the rights of the federal government

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<sup>202</sup> 440 U.S. at 727.

<sup>203</sup> *Id.* (quoting *United States v. Little Lake Misere Land Co.*, 412 U.S. 580, 593 (1973)).

<sup>204</sup> *Id.* (quoting *Clearfield Trust Co. v. United States*, 318 U.S. 363, 367 (1943)).

<sup>205</sup> *See id.* at 728.

<sup>206</sup> *See id.*

<sup>207</sup> *See id.* at 727-40.

<sup>208</sup> *See id.* at 727.

<sup>209</sup> *See id.*

<sup>210</sup> *See id.* at 728-29.

<sup>211</sup> *Id.* at 719 (citing *United States v. Standard Oil Co.*, 332 U.S. at 309).

against private creditors would “in no way hinder administration of the SBA and [FmHA] loan programs.”<sup>212</sup>

The Government argued unsuccessfully that the application of state law would conflict with program objectives by making it difficult to recover disbursed funds.<sup>213</sup> In response, the Court concluded that

when the United States acts as a lender or a guarantor, it does so voluntarily, with detailed knowledge of the borrower’s financial status. The agencies evaluate the risks associated with each loan, examine the interests of other creditors, choose the security believed necessary to assure repayment, and set the terms of every agreement. By carefully selecting loan recipients and tailoring each transaction with state law in mind, the agencies are fully capable of establishing terms that will secure repayment.<sup>214</sup>

The Government also argued that, in its posture as a social welfare agency making loans to individuals who could not secure credit from private lenders, it needs greater protection than that afforded ordinary creditors.<sup>215</sup> The Court found this argument unpersuasive as the agencies did not “indiscriminately distribute public funds and hope that reimbursement will follow.”<sup>216</sup> Both agencies had extensive rules and instructions to insure that loan recipients were financially reliable and to prevent improvident loans.<sup>217</sup>

Price supports in the form of CCC loans arguably fall within the rationale of *Kimbell Foods*. The Government takes a security interest in the grain in exchange for the loan. In most cases the grain will be encumbered with a prior lien which was created before the crop was planted. The federal interest may easily be perfected under state law without impairing the ability of the agency to operate the program. Because the government lender will generally have a lien of lower priority than the private lender, it might stretch *Kimbell Foods* a little to argue that under such circumstances the government lender does not need extra

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<sup>212</sup> See *id.* at 729.

<sup>213</sup> *Id.* at 733.

<sup>214</sup> *Id.* at 736 (citations omitted).

<sup>215</sup> See *id.* at 737.

<sup>216</sup> *Id.*

<sup>217</sup> *Id.*

protection. The CCC has instituted a practice of insisting on subordination agreements or lien waivers as a prerequisite to advancing money, effectively avoiding the difficult priority problem. One might wonder what the outcome would be if the private lender refused to execute the waiver. In that case, the situation could well be characterized as falling outside *Kimbell Foods* because, in effect, the lender would be depriving the farmer of an opportunity to participate in a price support program and would thereby directly frustrate specific federal price support policies. Under those circumstances, a court might well fashion a special federal rule giving the government its needed protection and removing the loans from Article Nine claims.

Most price support payments, however, do not raise the priority issue addressed in *Kimbell Foods*. Support programs involve a number of federal policies that have little, if anything, to do with credit availability.<sup>218</sup> However, it is arguable that if the application of state law, in a situation where a federal credit interest is not involved, could be shown to jeopardize or frustrate those other federal policies, the rule in *Kimbell Foods* would require that a separate national rule be fashioned and that state law not be applied.

It is significant that in *Kimbell Foods*, Congress had not spoken with respect to the priority of the federal claims. At least with respect to PIK, however, it may be argued that the implementing regulations do address the problem of liens under state law. Federal regulations provide:

Except as provided in sub-paragraph (e) of this section, any payment in kind or portion thereof which is due any person shall 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.<sup>219</sup>

Subparagraph (e) provides that

Assignments with respect to quantities of a commodity which can be received by a producer as payment in kind will be recognized by the Department [of Agriculture] only if such

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<sup>218</sup> See text accompanying note 129 *supra*.

<sup>219</sup> 7 C.F.R. § 770.6(f) (1984).

assignment is made on Form CCC-479, Assignment of Payment-In-Kind, executed by the assignor and assignee, and filed with the county committee.<sup>220</sup>

Although this regulation represents a statement by the USDA, and not by Congress, it is clear that a federal position has been taken at least with respect to some liens under state law. This arguably takes the matter outside of the *Kimbell Foods* rationale and allows a court to refuse to apply state law to the issue. On the other hand, the above provision could be construed as affecting only liens on the grain while in storage and not on the grain after it is in the hands of the PIK participant. In that case, the grain would pass free of any prior liens but might still be subject to claims of the creditors of the PIK participant. This seems a more reasonable construction. Nevertheless, if the impact of the provision is to cut off some liens (albeit those held against the grain while it was in storage), it may serve as evidence of a legislative intent to free the PIK grain from claims of creditors generally. Before state law can be applied to any payment under a federal price support program it is necessary to determine whether the purpose of the program could be effectively accomplished if the grain were not shielded entirely from the claims of creditors both before and after the PIK transfer.

With price support programs, the government is attempting to do much more than put money in the hands of farmers. It is attempting to influence total farm production of the supported commodity to benefit both farmers and consumers.<sup>221</sup> However, because of the peculiarities of supply and demand in the farm marketplace, reaching this goal has inevitably meant setting the farm support price higher than the market price while not passing the cost on to the consumer.<sup>222</sup> Recently, the most effective device has been the nonrecourse loan, where the government is a "tentative purchaser" until the market acts and then becomes the final owner of the grain if the market does not act favorably.<sup>223</sup> Market failures inevitably generate surplus stocks in the hands of the government which are expensive to manage. The

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<sup>220</sup> 7 C.F.R. § 770.6(e) (1984).

<sup>221</sup> See text accompanying notes 73-76, 102-106 *supra*.

<sup>222</sup> See text accompanying notes 115-17 *supra*.

<sup>223</sup> See text accompanying notes 117-32 *supra*.

only way to avoid these government surpluses is to sufficiently curtail production so that market forces drive prices up, reducing the possibility of a forfeiture to the government. The key to successfully reducing already existing surplus stocks is to either reduce production by insuring that enough farmers participate to have the necessary impact on the market price or to dispose of the surplus faster than it is acquired. For the last two years the government has employed the PIK program primarily as a device to dispose of the excessive government stocks and to drive total production down, and only secondarily as a means to put income in the hands of the farmer.<sup>224</sup>

In this context, even the CCC loans cannot be seen as just another source of credit. In reality, credit availability is not a major objective of the price support approach.<sup>225</sup> Therefore, where farmers do not participate in price support programs because of a fear that the benefits will immediately pass directly through to their creditors, or where their security agreements contemplate that only the crop itself would be the collateral, a strong argument would be made that the state law dealing with credit is discriminatory and has the effect of frustrating federal policy goals. As noted below, however, the acceptance of such an argument is unlikely.

The *Kimbell Foods* court indicated that one factor to be considered in determining whether to fashion a federal rule is the likely impact of such a rule on private credit.<sup>226</sup> It could be argued that the price support programs neither encourage nor promote the availability of private credit and that private lenders should not be seen as the intended beneficiaries of these programs. The decision to participate in the price support programs is a voluntary decision on the part of the farmer and the bank should have no opportunity to compel or discourage participation as a prerequisite to the granting of private credit. Indeed, if the farmer chooses not to participate, the bank is actually no worse off. Fiscal responsibility suggests that the bank should not determine the farmer's reliability as a borrower on the basis of a government price support expectancy. It is arguable, therefore,

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<sup>224</sup> See *PIK's Lasting Impact*, PROGRESSIVE FARMER 6 (Sept. 1983); *For the Future: Less Government Farm Aid*, PROGRESSIVE FARMER 19 (Sept. 1983).

<sup>225</sup> See text accompanying notes 73-76 *supra*.

<sup>226</sup> See 440 U.S. at 739-40.



that farm credit sources would not be significantly affected if the banks could not have access to the price support programs. Indeed, the difficulty of securing adequate credit in rural areas persists *despite* these payment programs, a situation which prompted the creation of the Federal Farm Credit System and the FmHA and SBA programs.<sup>227</sup>

Nearly all the cases that have addressed this issue appear to assume without question state law applies and then proceed to analyze the problem under Article Nine.<sup>228</sup> *Kimbell Foods*, on the other hand, seems to suggest that the beginning point of inquiry ought to be the impact of the state law on the federal program objectives,<sup>229</sup> which is quite a different matter. In most cases, courts appear content to apply state law on the theory that it should be left to Congress to fashion a national rule, and Congress, to date, has indicated no interest in creating such a rule.<sup>230</sup> In addition, there is a practical problem in raising the federal price support issue since there is generally no federal security interest or other similar governmental stake. Further, the individual farmer undoubtedly lacks the data he needs to support his contention that application of state law frustrates federal policy. We, along with the courts, are therefore left with state law, primarily Article Nine, analysis of the issue.

#### IV. CREDITORS' CLAIMS AND PRIORITIES IN PRICE SUPPORTS

Part IV of this Article deals with whether the farmer's secured creditors can reach and hang onto the money or other

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<sup>227</sup> See generally H. SPURLOCK & R. BIRD, ECONOMICS, STATISTICS AND COOPERATIVES SERVICE, USDA, HOUSING CREDIT: A RURAL-URBAN COMPARISON, III, RURAL DEVELOPMENT RESEARCH REP. NO. 6 (1978).

<sup>228</sup> For a discussion of the cases, see text beginning at note 326 *infra*. Most of them ignore the *Kimbell Foods* problem. One exception is *In re Kruse*, 35 Bankr. 958 (Bankr. D. Kan. 1983), but even its treatment of the problem was summary. Without considering the nature or extent of the federal policies involved, the court simply concluded:

The Court does not believe application of state law in any way hinders the Government's attempt to stabilize the supply and demand problems through PIK. Furthermore, the Uniform Commercial Code is adopted in 49 states, and is itself a type of non-federal, national policy. Accordingly, under the rule of *Kimbell Foods*, state and not federal common law will govern resolution of the issues at bar.

*Id.* at 963.

<sup>229</sup> See 440 U.S. at 728.

<sup>230</sup> See text beginning with note 278 *infra*.

entitlements generated by the farmer's participation in price support programs. The legal analysis under Article Nine is different for each of the three types of programs and is affected by the special crop rules and the history and policies discussed in parts I and II of this Article.

#### A. *Post-production Loans*

In a postproduction loan, the federal government, usually through the CCC, will loan money to the farmer and will take a security interest in the farmer's stored grain. This procedure puts the government in competition with the farmer's prior general financier or crop lender for priority in the grain. An interesting preliminary question, however, is whether the prior lender can reach the loan proceeds.

Under section 9-306(1), a secured party is entitled to proceeds of any original collateral which is disposed of or exchanged. Therefore, the first question in the context of price support programs is whether the crop has in fact been "disposed of" and generated proceeds. Obviously, the farmer has not sold the grain, and it is difficult, at first glance, to see how grain sitting in a warehouse can be said to have been disposed of in any way. Moreover, storage of the grain will not cut off the lender's original security interest.<sup>231</sup> Since access to proceeds is based on the concept of substitute collateral, until the original leaves the farmer's control through exchange or other disposition,<sup>232</sup> there would normally be little need to consider proceeds. This analysis, however, does not answer the question. The Code makes quite clear that disposition of the collateral does not always, or even usually, cut off a security interest.<sup>233</sup> Thus, absent a statutory exception,<sup>234</sup> the usual result of a disposition is that the lender ends up doubling his security: he now may claim the proceeds in addition to the original collateral.<sup>235</sup> There is no reason this should not also be the case for farm lenders.

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<sup>231</sup> Cf. *Oxford Prod. Credit Ass'n v. Dye*, 368 So. 2d 241, 242 (Miss. 1979).

<sup>232</sup> See U.C.C. § 9-306 comment 2.

<sup>233</sup> See U.C.C. § 9-306(2).

<sup>234</sup> See, e.g., U.C.C. § 9-307(1) (for buyers in ordinary course of nonfarm collateral).

<sup>235</sup> Comment 3 to U.S.C. § 9-306 states in pertinent part: "The secured party may claim both proceeds and collateral, but may of course have only one satisfaction."

It has been recognized, in the farm context at least, that section 9-306 should be read broadly to include "any type of disposition, actual or constructive."<sup>236</sup> Many courts have taken a less generous view and have refused to find a disposition<sup>237</sup> unless there was a "sale" within the meaning of Article Two, including passage of title.<sup>238</sup> However, the expansive view seems more appropriate especially in the farm context. Courts have recognized that farm security agreements are drafted with one eye on federal subsidy programs and have held that direct payments for such purposes as substandard or abandoned crops are proceeds to a prior secured lender.<sup>239</sup> At least one court has stated that diminished crop yield amounted to a constructive disposition sufficient to generate proceeds under section 9-306.<sup>240</sup> Thus, it would seem that storage, especially if made for the purpose of obtaining a CCC loan, is a disposition and the loan proceeds should be covered under section 9-306.

Supporting authority can be found in nonfarm cases. In *National Acceptance Co. v. Virginia Capital Bank*,<sup>241</sup> the plaintiff lender had made advances under a general financing arrangement resembling an assignment of accounts receivable. The court held that this financing arrangement was a "disposition" of the collateral and that funds advanced pursuant to it were proceeds both to the advancing creditor and to another secured creditor who also had an interest in the accounts.<sup>242</sup> It does not seem too

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<sup>236</sup> *In re Nivens*, 22 Bankr. 287, 291 n.4 (Bankr. N.D. Tex. 1982). See also *In re Munger*, 495 F.2d 511, 513 (9th Cir. 1974) (" 'proceeds' is to be given a flexible and broad content").

<sup>237</sup> See, e.g., *Mechanics Nat'l Bank of Worcester v. Gaucher*, 386 N.E.2d 1052, 1055 (Mass. App. Ct. 1979).

<sup>238</sup> U.C.C. §§ 2-106, 2-401. See also *In re Cleary Bros. Constr. Co., Inc.*, 9 Bankr. 40, 41 (Bankr. S.D. Fla. 1980) (money received from lease of goods was not proceeds since there was no final or permanent disposition).

<sup>239</sup> See, e.g., *In re Munger*, 495 F.2d at 512-13.

<sup>240</sup> See, e.g., *In re Nivens*, 22 Bankr. at 291, n.4.

<sup>241</sup> 498 F. Supp. 1078 (E.D. Va. 1980). See also *United States v. Mitchell*, 666 F.2d 1385, 1388 (11th Cir.) (storing soybeans for subsequent sale was disposition; advance payment to farmer was proceeds), *cert. denied*, 457 U.S. 1124 (1982). But see *J & J Auto Sales, Inc.*, 9 U.C.C. Rep. Serv. (Callaghan) 909, 912 (Bankr. E.D. Tenn. 1971) ("proceeds" does not include contract rights based on separate agreement between debtor and third party). In *J & J Auto Sales*, the dealer received a percentage of the wholesale cost of each new car sold at retail. The court inexplicably held these funds were not derived from the sale. See *id.*

<sup>242</sup> See 498 F. Supp. at 1082.

great a leap from this ruling to suggest that the granting of a security interest is a sufficient disposition to generate proceeds. The farmer's prior crop lender should then be entitled to reach the proceeds of postharvest government loans under this theory as well.

One must consider, however, whether the policies behind the federal programs might somehow change the analysis. Presumably, most commodity loans are made for general purposes such as operating expenses. In addition, one of the principal purposes of these loans is to increase the farmer's income.<sup>243</sup> This is accomplished by the nonrecourse nature of the loans and the release mechanisms for repayment.<sup>244</sup> If the farmer's creditors are entitled to snatch up the loan proceeds, the income purpose of the program will be defeated. Further, while farm income is normally the source from which farmers will repay their loans, lenders have no security interest in this income simply because the farmer owes them money. To allow them to claim postharvest loan proceeds might give them an unfair advantage and therefore be detrimental to the farmer. If the government wanted the funds to go to the farmer's creditors, it could always pay them directly. This would also remove their conflicting, and probably prior, security interests in the underlying grain.

But this argument has internal inconsistencies. As most farm income comes from the sale of farm products, the proceeds of these sales can always be reached by the farmer's secured lenders. Since government loans are intended precisely to compensate for poor sale returns, it makes little sense to treat those proceeds differently.

As a practical matter, however, this may be a moot question. In any case where creditors are disputing the rights to a farmer's assets, the proceeds will likely have already been spent. The contested issue in these cases is likely to be which creditor has the best claim to the stored grain, and this priority struggle boils down to one between two secured creditors. It would seem that the ordinary first-to-file-or-perfect rule of Code section 9-312(5)

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<sup>243</sup> See text accompanying notes 75, 102 *supra*. It should be noted further that another major purpose behind price supports is to reduce total national production and stocks of surplus grain, regardless of whether an individual farmer's income position is enhanced. See text accompanying notes 115-17 *supra*.

<sup>244</sup> See descriptions of federal subsidy programs in Sections I and II *supra*.

would control in this situation. A prior crop lender who properly perfected should have priority over the government in the stored grain. But this issue seems never to have arisen. Perhaps this is because the CCC nearly always insists on getting subordination agreements from the farmer's prior lenders.<sup>245</sup> Subordination agreements are valid under section 9-316 and, if used, cause the prior crop lender to lose its priority. If the lender does not agree to subordination, the government may well decline to extend the funds and the farmer may be driven into default or bankruptcy. The crop lender's lot, alas, is not a happy one.

### B. Purchases

A commodity purchase by the CCC obviously involves a disposition of collateral within the meaning of Code section 9-306(1), and the farmer's crop lender, just as obviously, may reach the sale proceeds.<sup>246</sup> The more interesting question here is whether the sale cuts off the prior lender's security interest in the crops themselves. On the surface, the answer seems easy. Assuming the crops were farm products at the time of sale, the special rule of section 9-307(1) applies, and the lender would have priority.<sup>247</sup> However, there are at least two other possibilities which must be considered—first, whether the lender might have authorized the sale in some way, and second, whether the lender's interest might be cut off if the grain was warehoused off the farm before the sale. The policies of price support programs will also affect the analysis of these issues.

#### 1. Authorized Sale

Under section 9-306(2), a security interest is cut off if "the disposition was authorized by the secured party." Most of the cases dealing with the issue of implied authorization have involved livestock, and the courts most often have sided with the lender.<sup>248</sup> There is not much to be gained by debating the point

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<sup>245</sup> See text accompanying notes 217-27 *supra*.

<sup>246</sup> See U.C.C. § 9-306(1), (3).

<sup>247</sup> For a discussion of this rule see text accompanying notes 40-51 *supra*.

<sup>248</sup> The leading case is *Garden City Prod. Credit Ass'n v. Lannan*, 186 N.W.2d 99 (Neb. 1971). See generally B. CLARK, *supra* note 39, at ¶ 8.4[3][c].

in the crop context.<sup>249</sup> Besides, it is always possible, on the facts of a given case, that an express waiver can be found.<sup>250</sup>

A more interesting problem is whether the general circumstances of crop lending might inherently authorize the farmer to deal with the CCC and whether, therefore, a sale to the CCC under a commodity purchase program might be considered "authorized by the secured party" within the meaning of Code section 9-306(2). In *In re Sunberg*,<sup>251</sup> the court ruled that a farmer's secured creditor could reach PIK entitlements as after-acquired general intangibles.<sup>252</sup> The court noted that government subsidy programs dominate modern farming and that the parties must have dealt with each other with these programs in mind.<sup>253</sup> In *Sunberg*, this overall context worked to the lender's advantage since the court felt it was the parties' unexpressed intention that rights under the PIK program be reached by a general security agreement covering all the debtor's farm property interests.<sup>254</sup>

Presumably the parties deal with each other within the context of all farm subsidies, including commodity purchases. If the lender and the farmer both know that the farmer might sign up for a commodity purchase program, it is logical to argue that the lender has given advance consent for this participation. The lender's security interest would subsequently be lost under section 9-306(2) when the sale to the CCC occurred.<sup>255</sup> This result would place farm commodity purchases more in line with the general law regarding inventory purchases, where expectations are similar. It may also further the purposes of the government's purchase program. The lender is not hurt since it can get the proceeds, and the grain, now in the hands of the government,

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<sup>249</sup> For a case involving crops, see *Vermilion County Prod. Credit Ass'n v. Izzard*, 249 N.E.2d 352 (Ill. App. 1969). See also *In re Thomas*, 38 Bankr. 50 (Bankr. N.D. 1983); *Mammoth Cave Prod. Credit Ass'n v. Oldham*, 569 S.W.2d 833 (Tenn. Ct. App. 1977).

<sup>250</sup> See, e.g., *North Cent. Kansas Prod. Credit Ass'n v. Washington Sales Co.*, 577 P.2d 35 (Kan. 1978).

<sup>251</sup> 729 F.2d 561 (8th Cir. 1984).

<sup>252</sup> See *id.* at 562.

<sup>253</sup> See *id.*

<sup>254</sup> See *id.* at 562-63.

<sup>255</sup> Under U.C.C. § 9-306(2), if the disposition was authorized by the secured party in the security agreement or otherwise, a sale, exchange or other disposition of the collateral cuts off the security interest.

will very likely be held for distribution under PIK or some other program.

## 2. *Off-farm Storage*

Farmers often store harvested crops in commercial warehouses. The warehouses for the farmers' accounts, then, often sell these crops to ordinary course buyers. The Code provides two possible arguments under which the farmer's secured lender might be cut off by these sales.

The first possibility is that the crops have ceased to be farm products, and as a result, the special exception for ordinary course buyers of farm products in section 9-307(1) would not apply. Under section 9-109(3), to be farm products the crops must be "in the possession of a debtor engaged in . . . farming operations." The statutory question is whether off-farm storage puts the crops out of the farmer's possession and thereby transforms them into inventory.

The term "possession" is used nearly four dozen times and appears in every article of the UCC,<sup>256</sup> but it is defined nowhere. The drafters clearly meant to leave the definition to case-by-case development according to context. Off-farm storage involves a temporary shift in location of the collateral pending sale, and it removes the crop from the farmer's physical custody. But physical custody may not be the only, or even the determining, test. The farmer will probably get a warehouse receipt representing the stored crop, and, if so, he will continue to have control over the crop. Since control is one of the key attributes of possession, holding a warehouse receipt might be read as the equivalent of possession for purposes of section 9-109(3).

This approach would be consistent with the Code's treatment of perfection of security interests in warehoused goods.<sup>257</sup> Under section 9-304(3), when a nonnegotiable warehouse receipt is issued, a secured party may perfect by notifying the warehouseman. This is deemed, under section 9-305, to constitute possession of the goods by the secured party. The secured party, in turn, must acquire possession of the receipt from the debtor, the

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<sup>256</sup> See, e.g., U.C.C. §§ 1-201(14) ("[d]elivery . . . means voluntary transfer of possession"), 2-103(1)(c) ("['r]eceipt' of goods means taking physical possession").

<sup>257</sup> See U.C.C. § 9-304(3).

person who granted the security interest. Therefore, it would be inconsistent to hold that the debtor did not have possession of the warehoused crop in the first place. Moreover, if this argument holds for situations involving nonnegotiable receipts, it must also hold when there is a negotiable receipt. Here, the only way to deal with the goods is through the receipt.<sup>258</sup> It would seem that the person who has possession of the receipt should be deemed to have possession of the goods. This is especially true when the purpose of determining possession is not to allocate risk of loss or destruction, but is merely to assign the goods to categories that are inevitably artificial.

A conclusion that off-farm storage does not transform the crops into inventory would also be consistent with the result in cases involving on-farm storage.<sup>259</sup> Surely a farmer who stores grain in his own silo or warehouse is in possession of the grain, and its character as farm products is not open to serious question.<sup>260</sup> The result should not be different when a farmer stores his grain in someone else's storage facilities.

Even if we assume the crops become inventory when they are stored off the farm, the consequence to the buyer-lender is not crystal clear. At first glance it would seem that the general rule of section 9-307(1) applies, and that the buyer would cut off the farmer's prior secured creditor.<sup>261</sup> Most farmers would easily qualify as being "in the business of selling goods of that kind" so that the buyer would qualify as one "in ordinary course of business."<sup>262</sup> Also, assuming that the farmer did not sell the

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<sup>258</sup> See, e.g., U.C.C. §§ 7-502, 9-304(4).

<sup>259</sup> See *Oxford Prod. Credit Ass'n v. Dye*, 368 So. 2d 241 (Miss. 1979). The court in *Dye* did not state whether storage was on or off the farm, but the context seems to indicate on-farm storage. The court held the goods were farm products. *Id.* at 242.

<sup>260</sup> See U.C.C. § 9-109(3).

<sup>261</sup> Under the general rule of U.C.C. § 9-307(1), "[a] buyer in ordinary course of business . . . takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence.

<sup>262</sup> A "buyer in ordinary course of business" must buy "from a person in the business of selling goods of that kind." U.C.C. § 1-201(9). Under Article 2, a "merchant" is "a person who deals in goods of the kind." U.C.C. § 2-104(1). There is endless confusion in the courts over whether a farmer should be treated as a "merchant." In Kansas, an important farming state, the courts have answered both ways, depending on the context. *Compare* *Decatur Coop Ass'n v. Urban*, 547 P.2d 323, 329 (Kan. 1976) (farmer not a merchant for purposes of statute of frauds) *with* *Musil v. Hendrich*, 627 P.2d 367, 373 (Kan. Ct. App. 1981) (farmer is a merchant for purposes of the implied warranty of merchantability). While a buyer in ordinary course will nearly always buy



grain to the warehouse, the security interest at stake was "created by [the] seller" and would be cut off under section 9-307(1).<sup>263</sup>

The analysis may not be this simple, however. Professor Gilmore has suggested that merely changing the character of the collateral may not defeat a claim by a prior secured creditor.<sup>264</sup> He posits the following case:

[A] debtor acquires goods, let us assume, as equipment for use in his business or as consumer goods for his own use. Thereafter and without the knowledge of the secured party the debtor, who happens to be a dealer, puts the goods in his inventory and sells them to a good faith buyer without notice in a transaction which is, from the buyer's point of view, entirely in ordinary course.<sup>265</sup>

Gilmore first correctly noted that the changed use does not, of itself, affect the secured party's perfection, even though the new character of the collateral would have required an original filing in a different place.<sup>266</sup> From this he concludes that the debtor's wrongful act of putting equipment or consumer goods into inventory should not vary priorities and the rule of section 9-307(1) should not apply.<sup>267</sup>

Even if Gilmore is correct, the farm situation may nevertheless call for a different result. Gilmore suggests that section 9-307(1) should cut off only a secured party which knows when it enters the transaction that it "is financing goods of a type which the [debtor] can sell to a 'buyer in ordinary course of business.'" <sup>268</sup> The crop lender not only knows of this possibility, it

from a merchant, this need not be the determinative factor. In deciding whether a farmer is to be held to higher merchant standards under Article 2, the courts are worried about different policy considerations than those raised by Article 9 questions. In a dispute under § 9-307(1), it is no burden on the farmer to decide that he is in the business of selling grain so that his buyer qualifies as a buyer in ordinary course. It should make no difference whether he is also a "merchant" under Article 2.

<sup>263</sup> See note 261 *supra*.

<sup>264</sup> See 2 G. GILMORE, *supra* note 6, at § 26.8.

<sup>265</sup> *Id.* at 699.

<sup>266</sup> See U.C.C. § 9-401(3). Gilmore's treatise cites § 9-401(2); presumably this is a misprint. See 2 G. GILMORE, *supra* note 6, at 700. The context, the language, and the cross-reference to § 18.22 of the treatise all indicate that he meant to cite § 9-401(3). This subsection was not renumbered in the 1972 UCC revisions.

<sup>267</sup> See 2 G. GILMORE, *supra* note 6, at 700.

<sup>268</sup> *Id.*

hopes the farmer will sell in the ordinary course. It also knows, or should know, that harvested grain very often ends up in a commercial warehouse. Even if this process causes the grain to shift from one arbitrary statutory classification to another, everyone knows the shift is likely to occur.

Furthermore, it is not at all clear that the transaction should not be considered from the buyer's viewpoint.<sup>269</sup> In *United States v. Hext*,<sup>270</sup> the court stressed the buyer's viewpoint in a farm storage situation. The debtor in *Hext* was a cotton farmer who owned his own separately incorporated ginning operation. The cotton was harvested by the farmer, ginned by the farmer's company, and then stored in a commercial warehouse. Negotiable warehouse receipts were issued in the name of the ginning company. The cotton was later sold through a brokerage firm by sight drafts against the warehouse receipts.<sup>271</sup> The court pointed out that the prior secured creditor—in this case the United States—was aware all along that the cotton would be ginned and marketed by the farmer/debtor through his own ginning company.<sup>272</sup> The court also noted that neither the warehouse nor the broker had actual knowledge of the prior security interest.<sup>273</sup>

Regarding the rights of the prior secured party as against the ultimate buyer, the court made several observations. In the average case (although not in *Hext*) the farmer would sell his cotton to an independent gin. This sale would be covered by the farm products exception to section 9-307(1), and the secured party's rights would not be affected. When the gin later sold the cotton, the secured party would continue to be protected, since, under section 9-307(1), a buyer cuts off only prior security interests "created by his seller."<sup>274</sup> In *Hext* itself, the prior creditor lost to the buyer. The court recognized that ginned cotton is still farm products,<sup>275</sup> so the exception would seem to apply and protect the secured party. However, the court noted that from the buyer's point of view the sale was made by the

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<sup>269</sup> See *id.*

<sup>270</sup> 444 F.2d 804 (5th Cir. 1971).

<sup>271</sup> See *id.* at 805-06.

<sup>272</sup> See *id.* at 812.

<sup>273</sup> See *id.* at 816.

<sup>274</sup> *Id.* at 814 (quoting U.C.C. § 9-307(2)).

<sup>275</sup> See *id.* at 813.

ginning company.<sup>276</sup> Because the gin, unlike the farmer, was not "a person engaged in farming operations," the farm products exception did not apply.<sup>277</sup> In addition, after treating the farmer and the gin as separate persons to solve the "farming operations" problem, the court then treated them as the same person to iron out the "created by his seller" wrinkle.<sup>278</sup> The court justified this result through the secured party's prior knowledge that the farmer ginned his own cotton.<sup>279</sup>

Where all of this leads in the context of commodity purchase programs is unclear. If, as seems likely, storage does not cause farm products to lose their character, then the farm products exception would seem to apply and protect the prior farm lender at the expense of the government as buyer. This result is particularly intriguing in light of the drafters' fear that abolishing the farm products exception in section 9-307(1) would cause the government to reenact it as federal law.<sup>280</sup> That fear considered only the government's role as lender; here, the government is buyer. Presumably, even the federal government should not have it both ways.

But even if storage does not create inventory out of farm products, the crop lender's troubles are not over. When the farmer stores the grain, the warehouseman will probably issue a warehouse receipt to the farmer.<sup>281</sup> If everyone is playing above-board, the receipt may even be issued jointly to the farmer and his lender; in either case, the lender will have rights in the receipt. Ideally, when the warehouse sells the grain for the farmer's account, the receipt will be duly negotiated (or transferred if it is nonnegotiable)<sup>282</sup> to the buyer. This gives the buyer all rights in the grain<sup>283</sup> and cuts off by consent the secured lender's rights.

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<sup>276</sup> *Id.*

<sup>277</sup> *Id.* at 813-14.

<sup>278</sup> *See id.* at 814.

<sup>279</sup> *See id.*

<sup>280</sup> *See* note 50 *supra* and accompanying text.

<sup>281</sup> The warehouseman may issue something less formal, such as a scale or weight ticket. Those tickets are used for the same basic purposes and would seem to qualify as warehouse receipts under U.C.C. § 1-201(45). *Cf.* U.C.C. § 1-201(15) (warehouse receipt is a document of title if "issued by or addressed to a bailee"). *Cf. also* Hartford Accident & Indem. Co. v. Kansas, 247 F.2d 315, 320 (10th Cir. 1957); State *ex rel.* Crawford v. Centerville Grain Co., 618 P.2d 1206, 1212 (Kan. Ct. App. 1980). Both *Hartford* and *Crawford* treat scale tickets as warehouse receipts.

<sup>282</sup> Only a negotiable receipt can be negotiated. U.C.C. § 7-501.

<sup>283</sup> *See* U.C.C. § 7-502.

Commercial practice, however, may not always be so tidy. The warehouse may sell the grain in the ordinary course to grain merchants and the like without bothering to transfer the warehouse receipts. Even this practice may produce no dire consequences as long as the proceeds are paid over to the farmer and, especially, to his financier (and as long as the receipts are cancelled). But warehousemen have been known to abscond with the proceeds, and the practice of selling without accounting for the receipts may produce a shortage. Here, the farmer and his bank, and other farmers and their banks, have obvious claims against the warehouse as issuer of the documents.<sup>284</sup> However, since there is not likely to be enough grain to go around, it is important to know whether the bank can recover from the buyer.

Under section 7-205 the answer is no. This section applies to fungible goods sold and delivered by a warehouseman. An ordinary course buyer who is in the business of dealing in the particular goods cuts off the right of anyone who claims through the warehouse receipts.<sup>285</sup> This section is thus an exception to Code section 9-307(1) and permits a buyer in ordinary course of farm products to take free of a prior security interest.<sup>286</sup>

Section 7-205 has been applied against the government as crop lender.<sup>287</sup> Whether the government as buyer under the commodity purchase program would be protected by this same section is not clear, however. Presumably the CCC qualifies as a buyer who deals with the particular goods. But it has been held that this section requires an actual sale and physical delivery of the goods; a sale by mere transfer of the warehouse receipts is not enough.<sup>288</sup> If this is the rule, the CCC would often not qualify. The CCC regularly takes delivery of certain processed dairy products, but most other commodities are left in storage

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<sup>284</sup> See U.C.C. § 7-403. See also *Preston v. United States*, 696 F.2d 528, 536 (7th Cir. 1982).

<sup>285</sup> See U.C.C. § 7-205.

<sup>286</sup> It is possible to read U.C.C. § 7-205 as cutting off only those rights claimed by the creditor through the receipt. This leaves it open to the creditor to argue that its rights under Article 9 exist independently of the receipt and are not disturbed. This argument seems strained; § 7-205 should be read as an exception to § 9-307(1) (more precisely, to the § 9-307(1) exception).

<sup>287</sup> See, e.g., *In re Fairfield Elevator Co.*, 14 U.C.C. Rep. Serv. (Callaghan) 96, 100-102 (Bankr. S.D. Iowa 1973).

<sup>288</sup> See *Midland Bean Co. v. Farmers State Bank*, 552 P.2d 317, 323 (Colo. Ct. App. 1976).

facilities — which have been contracted for under the purchase program — until they are resold for export or donated for use in various domestic and foreign assistance programs.<sup>289</sup> To take advantage of the cut-off rights under section 7-205, the CCC would have to take delivery and then, presumably, restore the commodities in another contracted warehouse.<sup>290</sup> This procedure would be cumbersome and wasteful and there seems no reason the CCC should not be protected here as it would be in the dairy cases. Looking to avoid the effects of the delivery requirement, a court might find this just the place to apply a special federal priority rule.<sup>291</sup> But Code drafters feared this approach all along.<sup>292</sup> Perhaps the desired result could be reached under section 7-205 by considering that, by virtue of the warehouseman's agreement to act for the CCC under the program, the CCC has taken either constructive delivery or delivery through an agent.

Of course this problem does not arise if the CCC, as buyer, is careful to take warehouse receipts. In fact, it sometimes happens that the farmer fails to turn the receipts over to its crop lender and instead delivers them directly to the buyer, thus allowing the buyer to acquire rights superior to those of the lender.<sup>293</sup> If the receipt were negotiable, the buyer is very likely to become a holder by "due negotiation."<sup>294</sup> This status gives the buyer rights superior to those of even prior perfected secured creditors.<sup>295</sup> Code section 7-503 protects some prior secured parties who had their rights perfected before the receipt was issued. However, the secured party loses its protection under this provision if it entrusts the goods to the debtor with authority, actual or apparent, either to store them or to dispose of them in any

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<sup>289</sup> See I J. JUERGENSMAYER & J. WADLEY, *supra* note 3, at 261.

<sup>290</sup> See, e.g., 552 P.2d at 323 (The word "delivered" under U.C.C. § 7-205 "means delivered in fact, not symbolic delivery by means of a transfer of documents." (emphasis in original)).

<sup>291</sup> For a discussion of this issue, see notes 219-28 *supra* and accompanying text.

<sup>292</sup> See note 50 *supra* and accompanying text. On the other hand, since most price support payments do not involve the federal government as lender, the credit issues are not the same in price support situations as in the Kimbell Foods loans, and hence, a separate federal rule may be entirely justified. See text accompanying notes 217-28 *supra*.

<sup>293</sup> See U.C.C. §§ 7-504, 9-301(1)(c).

<sup>294</sup> See U.C.C. § 3-202.

<sup>295</sup> See U.C.C. § 9-309.

way.<sup>296</sup> The secured party also loses if it acquiesces in the farmer's procurement of the receipt.<sup>297</sup> In the context of farming authority to store harvested crops would seem to be implied in nearly all situations.<sup>298</sup> Thus, the buyer who takes a negotiable warehouse receipt will have priority over the prior creditor.<sup>299</sup> The CCC normally takes negotiable warehouse receipts and would therefore be protected by these rules.

A buyer under nonnegotiable receipts, however, has fewer rights.<sup>300</sup> Under section 7-504(1), a transferee of a nonnegotiable warehouse receipt or other document of title acquires the rights the transferor "had or had actual authority to convey." Assuming the lender gave no authorization, these rights are subject to the lender's prior security interest. As noted above, the bank will very likely have entrusted or acquiesced under section 7-503.<sup>301</sup> But it has been held that section 7-503 applies only to negotiable documents because that section deals with rights acquired by due negotiation.<sup>302</sup> Thus, when nonnegotiable documents are involved, it takes actual authority to cut off the prior secured party.

Under section 7-504(2), the transferee who takes nonnegotiable receipts can enlarge its rights by giving notice to the warehouseman. Notice cuts off the rights of "those creditors of the transferor who could treat the sale as void under section 2-402."<sup>303</sup> But this reference includes only those creditors who might have rights under the law of fraudulent conveyances or ostensible ownership; secured creditors of the seller are unaffected.<sup>304</sup> Also, when goods are subject to a nonnegotiable document, the goods are still dealt with as goods. Unlike the situation

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<sup>296</sup> See U.C.C. § 7-503(1)(a).

<sup>297</sup> See U.C.C. § 7-503(1)(b).

<sup>298</sup> See text accompanying notes 268-69 *supra*.

<sup>299</sup> See U.C.C. § 7-503(1)(a).

<sup>300</sup> See U.C.C. § 7-504.

<sup>301</sup> See text accompanying notes 296-97 *supra*.

<sup>302</sup> See *Douglas-Guardian Warehouse Corp. v. Esclair Endsley Co.*, 10 U.C.C. Rep. Serv. (Callaghan) 176, 190 (W.D. Mich. 1971). See also *Philadelphia Nat'l Bank v. Irving R. Boody Co.*, 1 U.C.C. Rep. Serv. (Callaghan) 560, 565-66 (1963)(Funk, Arb.).

<sup>303</sup> U.C.C. § 7-504(2)(a) (1972).

<sup>304</sup> Under U.C.C. § 2-402(2) a creditor of the seller may treat the sale as void "if as against him a retention of possession by the seller is fraudulent under any rule of law of the state where the goods are situated." For an example of such a law, see *KAN. STAT. ANN. § 33-103* (1981).

involving negotiable receipts, the document is not a complete substitute for the goods. Thus, with a nonnegotiable receipt, the security interest would still be in the goods, the goods would probably still be farm products, and the farm products exception of section 9-307(1) would still apply to protect the prior secured creditor.

Again, we have a different result created by the special farm products rule. The fact that the result is different for a nonnegotiable document than for a negotiable document is not the problem; takers of negotiable paper often have greater rights.<sup>305</sup> But here, the distinction is created not by the character of the paper, but by the character of the underlying goods. For all but farm products, a buyer in ordinary course, even through a nonnegotiable document, cuts off the prior security interest under section 9-307(1). A buyer of farm products through a negotiable document accomplishes the same thing under section 9-309. The result should not be different for the buyer who happens to deal in farm products through nonnegotiable paper.

To sum up, the result of the priority struggle between a crop lender and the CCC as crop buyer is not at all clear under Article Nine. The lack of clarity is caused by the special exception to Code section 9-307(1) for ordinary course buyers of farm products. Absent this exception, which we have already suggested cannot be justified,<sup>306</sup> the lender would always lose its claim to the crops and would have to be content with the proceeds. Even under present law this result can be reached in all cases by holding that sale to the CCC is impliedly contemplated by all parties from the beginning and was therefore "authorized" within the meaning of section 9-306(2).<sup>307</sup> Apart from this, the prior crop lender will be cut off only if the crop is stored off the farm and either this storage is deemed (an unlikely result) to transform the crops from farm products into inventory<sup>308</sup> or if a negotiable warehouse receipt is issued and used to sell the crop to the CCC.<sup>309</sup>

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<sup>305</sup> Compare U.C.C. § 7-502 with U.C.C. § 7-504.

<sup>306</sup> See text accompanying notes 47-51 *supra*.

<sup>307</sup> See text accompanying note 255 *supra*.

<sup>308</sup> See text accompanying notes 261-63 *supra*.

<sup>309</sup> See text accompanying notes 281-83 *supra*.

This inconsistency and confusion should be eliminated, by amendment to the U.C.C. if necessary. Priority disputes should not be resolved on the basis of particular practices (for example, on- or off-farm storage and use of negotiable or nonnegotiable receipts) which may vary from farm to farm or region to region. These disputes should, instead, be analyzed with a view to the underlying policies and equities involved.

### C. *Direct Payments*

In direct payment programs, the government gives the farmer money or some other form of payment to make up for some deficiency in the crop produced or to persuade the farmer not to produce at all.<sup>310</sup> Since the government acquires neither ownership nor a security interest in the underlying crop, it presumably will have no stake in the outcome of any priority dispute. However, priority disputes are likely to arise among the farmer's other creditors — including, inevitably, the trustee in bankruptcy. The legal problem in each case is to identify the nature of each creditor's interest and then to apply the usual priority rules.<sup>311</sup> In direct payment programs this is not as easy as it sounds.

The first question is whether the prior secured creditor can reach the proceeds of these direct payments at all. This, in turn, depends somewhat on the nature of the specific programs — whether providing payments in cash or payments in kind.

#### 1. *The Nature of the Creditor's Claim*

##### a. *Cash Programs*

It seems settled that the crop lender can reach payments under cash programs as proceeds. In *In re Munger*<sup>312</sup> the security agreement covered “all crops” and the proceeds. The farmer received two types of federal cash payments. The first was based on the sugar content of harvested sugar beets; the second was

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<sup>310</sup> For a discussion of direct payment programs see text accompanying notes 139-52 *supra*.

<sup>311</sup> See U.C.C. §§ 9-301, 9-312.

<sup>312</sup> 495 F.2d 511 (9th Cir. 1974).



based on acreage abandoned because of crop disease.<sup>313</sup> In both instances, the court had little trouble concluding that the creditor could reach these payments as proceeds of the crop under Code section 9-306. The court noted that these payments were "an integral part of the sugar beet farming business," and that "the security agreements were drafted with an awareness of the importance of . . . federal subsidy payments to the realities of financing a farming operation based on sugar beets."<sup>314</sup> From this, the court concluded that the parties intended that the security agreement reach disaster payments.<sup>315</sup>

The court also noted that, since the amount of some of the payments was partially determined by marketing factors, these payments were closely connected with sale of the crop.<sup>316</sup> Of course, in a true sale, any payment received would be proceeds. Drawing an analogy to the sale concept, the court concluded that these payments would be "proceeds under even the most grudging interpretation of the security agreement."<sup>317</sup> Presumably, they would be "proceeds" under even "the most grudging interpretation" of section 9-306 as well.

The court in *In re Nivens*<sup>318</sup> agreed. In *Nivens* the government made deficiency and disaster payments to compensate for low yield. The payments were made after the crop was sold, and the court held that the crop lender could reach them as proceeds.<sup>319</sup> Although the *Nivens* court failed to discuss the possibility, because these payments are a form of insurance, they could also have been reached as proceeds. As the court pointed out in *Munger*, these payments are similar to insurance payments.<sup>320</sup> Indeed, some federal disaster payments of this type are labeled "insurance."<sup>321</sup> In the 1972 Official Text, Code section 9-306(1) expressly declares that casualty insurance payments are pro-

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<sup>313</sup> See *id.* at 513.

<sup>314</sup> *Id.*

<sup>315</sup> See *id.*

<sup>316</sup> See *id.*

<sup>317</sup> *Id.*

<sup>318</sup> 22 Bankr. 287 (Bankr. N.D. Tex. 1982).

<sup>319</sup> *Id.* at 289-94.

<sup>320</sup> See 495 F.2d at 513.

<sup>321</sup> For a discussion of crop insurance programs see I J. JUERGENSEMEYER AND J. WADLEY, *supra* note 3, at ch. 15.

ceeds.<sup>322</sup> Certainly, at least in states which have enacted the 1972 text, this should be conclusive, and federal disaster payments of this type should be considered proceeds. The majority of the 1962 Code states also take this view.<sup>323</sup>

Since the farmer's prior crop lender can reach federal cash subsidy payments as proceeds, it should have no trouble establishing its priority as against other claimants. Under section 9-306(3)(b), the original perfection extends to cash proceeds, and under section 9-312(6) this perfection is good against competing secured parties. If the payments are received after the farmer has filed bankruptcy, section 552(b) of the Bankruptcy Code<sup>324</sup> should protect the creditor against the trustee; however, payments received during the ninety day prebankruptcy period might be challenged as preferences.<sup>325</sup> Since this issue is worthy of separate discussion, we deal with it separately below.

#### b. *Payment In Kind (PIK) Programs*

Under PIK programs, the farmer receives grain as a substitute for a crop he either agrees to turn under or never plants in the first place.<sup>326</sup> The crop lender's intended collateral has thus ceased to exist or has never come into existence. Under what legal theory can the lender reach the PIK entitlements?

If the crop was once growing and was turned under as part of the farmer's agreement with the government, it is possible to conclude that the entitlements are proceeds under section 9-

<sup>322</sup> "Insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement." U.C.C. § 9-306(1).

<sup>323</sup> See, e.g., *In re Sexton*, 16 Bankr. 240, 245 (Bankr. E.D. Tenn. 1981); *Ettinger v. Central Penn Nat'l Bank*, 2 Bankr. 385, 892 (E.D. Pa. 1979), *rev'd on other grounds*, 634 F.2d 120 (3d Cir. 1980).

<sup>324</sup> 11 U.S.C. § 552(b) (1982) provides:

[I]f the debtor and a secured party enter into a security agreement before the commencement of the case . . . [which] extends to property of the debtor acquired before the commencement of the case and to proceeds . . . of such property, then such security interest extends to such proceeds . . . acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law. . . .

<sup>325</sup> See, e.g., *In re Nivens*, 22 Bankr. at 292-94.

<sup>326</sup> See, e.g., *In re Kruse*, 35 Bankr. 958, 961 (Bankr. D. Kan. 1983).

306.<sup>327</sup> The notion of "disposition" is probably broad enough to include plowing under, or other destruction, of existing collateral. While destruction of collateral is not normally encouraged, here it is a required part of a specific government program. As a result, the crop lender should be allowed to reach the entitlements as substitute collateral or as proceeds. In *In re Kruse*<sup>328</sup> the farmer signed up for the PIK program and agreed to turn under some growing crops and to refrain from planting others.<sup>329</sup> With respect to the growing crop, the court correctly held the PIK entitlements were proceeds and let the lender claim them as against the trustee. Since the case involved payments due after bankruptcy had been filed, the court based its ruling on Bankruptcy Code section 552(b).<sup>330</sup>

In cases where the farmer signs up for PIK before the crops are planted, the analysis is more complicated. If the farm lender relies exclusively on crops as security, one might well ask whether it has any security at all. As discussed in part I of this Article, after-acquired property clauses are no longer limited, and a lender may take future crops as collateral.<sup>331</sup> Such a clause does not apply if the future collateral never appears; therefore, how can there be proceeds of collateral which does not exist?<sup>332</sup>

Several courts have faced this question in PIK cases;<sup>333</sup> all but one ruled in favor of the creditor. The courts' theories, however, differ. In *In re Sunberg*<sup>334</sup> the farmer withheld corn acreage from production. The creditor, a production credit association (PCA), held a broad security interest in all of the debtor's present and after-acquired farm-related property, including crops and general intangibles.<sup>335</sup> In bankruptcy, the trustee challenged the PCA's claim to the PIK entitlements. The court affirmed the bankruptcy court's ruling that the entitlements were

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<sup>327</sup> " 'Proceeds' includes *whatever* is received upon the sale . . . or *other disposition* of collateral." U.C.C. § 9-306(1) (emphasis added).

<sup>328</sup> 35 Bankr. 958.

<sup>329</sup> See *id.* at 966.

<sup>330</sup> See *id.*

<sup>331</sup> See notes 8-17 *supra* and accompanying text.

<sup>332</sup> "To this Court's knowledge, no court has ever held that the rights under PIK, or any other entitlement program, stemming from an agreement not to grow crops, are proceeds of anything." 35 Bankr. at 966.

<sup>333</sup> See, e.g., *In re Sunberg*, 729 F.2d 561 (8th Cir. 1984).

<sup>334</sup> *Id.*

<sup>335</sup> See *id.* at 561-62.

general intangibles and that the PCA could reach them under the broad clause in the security agreement.<sup>336</sup> Any actual distributions of grain under these entitlements, even after bankruptcy, would be proceeds protected by Bankruptcy Code section 552(b).<sup>337</sup>

An alternative route to the PIK entitlements was taken in *In re Preisser*.<sup>338</sup> The government itself was the prior lender, but instead of a security interest in crops or other personal property, it held a real estate mortgage. The mortgage by its terms covered "rents, issues and profits,"<sup>339</sup> and the court held this clause was sufficient to reach PIK entitlements.<sup>340</sup> This analysis is less than wholly satisfactory. As noted earlier, crops are universally treated as personal property, not real property.<sup>341</sup> To get a security interest in crops, the lender must comply with Article Nine; real estate or mortgage law does not apply.<sup>342</sup> Thus, if *Preisser* means that the lender can reach crops (or their substitute, e.g., PIK) via a real estate mortgage, the decision is wrong.

On the other hand, it has long been recognized that, at some point in the mortgage transaction, the mortgagee is entitled to "rents, issues and profits" from the mortgaged land, including crops.<sup>343</sup> In so-called lien states, such as Colorado,<sup>344</sup> that right does not generally accrue until after foreclosure.<sup>345</sup> Thus, it would seem that the government's rights in *Preisser* would depend on whether foreclosure proceedings had been completed. The opinion gives us no clue. Since the debtor was in bankruptcy, we may presume default had occurred, but it is doubtful that foreclosure had been completed since the filing of bankruptcy would have stayed any foreclosure proceedings.<sup>346</sup> The court ignored all of this and said simply that PIK benefits "must

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<sup>336</sup> See *id.* at 562-63.

<sup>337</sup> See *id.* at 562.

<sup>338</sup> 33 Bankr. 65 (Bankr. D. Colo. 1983).

<sup>339</sup> *Id.* at 66.

<sup>340</sup> See *id.* at 66-67.

<sup>341</sup> See notes 4-5 *supra* and accompanying text.

<sup>342</sup> See, e.g., *United States v. Newcomb*, 682 F.2d 758, 761 (8th Cir. 1982).

<sup>343</sup> R. BROWN, *supra* note 5 at § 17.3.

<sup>344</sup> See COLO. REV. STAT. § 38-39-105 (1982).

<sup>345</sup> See R. BROWN, *supra* note 5 at § 17.3. See also G. OSBORNE, G. NELSON & D. WHITMAN, *supra* note 55 at § 4.26.

<sup>346</sup> See 11 U.S.C. § 362(a) (1982). See also *In re Jenkins*, 19 Bankr. 105, 109-10 (D. Colo. 1982).

be construed to be rents or profits of the land.”<sup>347</sup> The court based this conclusion on the fact that “any grain which the debtor had grown on this land would have been considered rents or profits of the land.”<sup>348</sup> As one court noted, *Preisser* “is factually deficient, [and] of minimal precedential value.”<sup>349</sup>

In a pair of Ohio cases, the courts faced the more difficult question of whether the creditor can reach PIK entitlements where the security agreement mentioned only “crops” and the crops never came into existence. The creditor was allowed to claim the PIK entitlements in both cases. In the first, *In re Lee*,<sup>350</sup> the court said the issue was “[w]hether the PIK benefits fall within the category of growing crops and their proceeds.”<sup>351</sup> The court first recognized that “PIK benefits are a substitute for the corn crop [the] debtors normally . . . planted.”<sup>352</sup> The court then simply held that since “any corn or proceeds of corn . . . would have been covered by the security interest . . . , its substitute—the benefits under the PIK program—should be treated the same.”<sup>353</sup>

In the second Ohio case, *In re Cupp*,<sup>354</sup> the court came to the same conclusion. As in *Lee*, the security agreement covered crops and proceeds, but said nothing about general intangibles. The debtor signed up for the PIK program before planting and then assigned his benefits to a partnership consisting of the debtor, his wife and his mother. The creditor sought to enjoin the assignment and establish its priority.<sup>355</sup> It could have priority only if its security agreement reached the PIK entitlements.

The court, in a well-reasoned opinion, ruled in favor of the creditor and gave two rationales for so doing. First, after discussing the policies of the federal programs and the broad reading given to the concept of “proceeds” in *Munger* and *Nivens*, the court ruled that the PIK benefits were “proceeds” under the

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<sup>347</sup> 33 Bankr. at 67.

<sup>348</sup> *Id.*

<sup>349</sup> *In re Kruse*, 35 Bankr. at 965.

<sup>350</sup> 35 Bankr. 663 (Bankr. N.D. Ohio 1983).

<sup>351</sup> *Id.* at 666.

<sup>352</sup> *Id.*

<sup>353</sup> *Id.*

<sup>354</sup> 38 Bankr. 953 (Bankr. N.D. Ohio 1984).

<sup>355</sup> *See id.* at 953-54.

security agreement.<sup>356</sup> This was so even though the crops were not planted and no original collateral could be identified.

Since the term 'proceeds' is intended to apply to that which is produced from a creditor's collateral which, in the absence of the PIK program, would have been grown, it must also apply to that which is produced as though it had been grown. Therefore, it would follow that PIK proceeds are proceeds of the crops within the meaning of the security agreement.

. . . .

It should also be noted that if this Court were to hold that PIK proceeds are not 'proceeds' an artificial distinction would be created between proceeds from the sale of crops actually grown and the proceeds received as though they had been grown. It would also create an unconscionable means by which a farmer could defeat a creditor's security. If PIK payments were not proceeds, a farmer could abandon all farming activities in favor of program participation, thereby allowing him to dissipate the proceeds of the programs without any regard for their [sic] creditor's interests. Such a result cannot be permitted.<sup>357</sup>

Second, the court said it could reach the same result simply by reading the obvious intent of the parties into the security agreement.<sup>358</sup> The court agreed with *Munger* that the parties entered the security agreement with both eyes open and with an awareness of the federal price support programs. "The comprehensive language of the agreement must be read in the context of that awareness."<sup>359</sup> Moreover,

[i]n view of the all-inclusive character of the agreement, it must be concluded that the contract expresses the intent that the Plaintiff was to acquire a security interest in whatever recompense the Debtor-In-Possession received as a farmer, regardless of whether it was for having raised crops or for participating in a government subsidy program. Accordingly, PIK proceeds would be included within the Plaintiff's security interest.<sup>360</sup>

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<sup>356</sup> See *id.* at 955.

<sup>357</sup> *Id.* at 955-56.

<sup>358</sup> See *id.*

<sup>359</sup> *Id.* at 956.

<sup>360</sup> *Id.*

This seems to be the correct way to interpret a farm security agreement.

In another case, *In re Kruse*,<sup>361</sup> the court denied the creditor's claim to PIK benefits based on crops never planted.<sup>362</sup> This decision may be explained primarily as turning on the particular bankruptcy setting involved. But the court went further and expressed doubt that the creditor could have won anyway.<sup>363</sup> The farmer had entered the PIK program, with the court's permission, after bankruptcy was filed. This brings into play Bankruptcy Code section 552 which cuts off the secured creditor's claim to postbankruptcy property under an after-acquired property clause, but which allows the creditor to reach postbankruptcy proceeds of prebankruptcy collateral.<sup>364</sup> The security agreement covered only crops, not "general intangibles," and there were no prebankruptcy crops subject to this claim. In this case, there were no prebankruptcy general intangibles either, but the court said that even the security agreement's mentioning them would not have helped.<sup>365</sup> The court did agree with the ruling in *Sunberg* that PIK entitlements were general intangibles.<sup>366</sup>

The court went on, however, to say that the PIK entitlements could not be claimed as proceeds, at least in cases where the crop had not been planted. The court treated the concept of "proceeds" as presuming the existence of some original collateral which is sold or otherwise disposed of. Finding no original collateral, the court held that the creditor had no claim.<sup>367</sup>

Under the *Kruse* approach, there are apparently only two paths to PIK entitlements: either the security agreement must expressly cover general intangibles, or the crop must first be planted and then plowed under.<sup>368</sup> We believe this approach is too limited and that the Ohio court in *Cupp*<sup>369</sup> offered a better analysis. The effect of *Kruse* is to make the crop lender's rights

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<sup>361</sup> 35 Bankr. 958.

<sup>362</sup> See *id.* at 966.

<sup>363</sup> See *id.*

<sup>364</sup> See 11 U.S.C. § 552(a)-(b) (1982).

<sup>365</sup> See 35 Bankr. at 966.

<sup>366</sup> See *id.*

<sup>367</sup> See *id.* See also note 332 *supra*.

<sup>368</sup> See 35 Bankr. at 966.

<sup>369</sup> 38 Bankr. 953.

turn on the extent to which the crop had been planted when the farmer signed up for the program. But planting should not be the controlling factor: under the PIK program, even a planted crop must be turned under. Whether the crop was planted the day before or was to be planted the day after is purely fortuitous. The net result is the same in both cases. Since the program is designed to create a substitute for noncrops in either case, the crop lender's right should be the same.

We should add that we have no trouble with the bankruptcy-ordained result on the specific facts of *Kruse*. The debtor had no right to anything before bankruptcy, since he had neither planted any crops nor enrolled in any government programs.<sup>370</sup> The creditor is no worse off than if the farmer, instead of signing up for PIK, had simply planted after filing bankruptcy. Any creditor who relies on after-acquired collateral or other future property runs the risk that the property may never come into existence or may come into existence only after bankruptcy.

The problem with *Kruse* is the restriction it seems to place on a creditor's rights. A farm lender who looks to crops as security, even in cases where the crop does not come into existence, ought to be allowed to claim property which is understood by everyone to be a specific substitute for those lost crops and whose existence is the very reason the crops do not exist. And this should be the case whether the security agreement happens to mention "general intangibles" and whether the lost crop was planted prior to entering the program.<sup>371</sup>

## 2. *Effect of Federal Regulations Requiring Assignment*

Most rights under government subsidy programs are expressly assignable. For this reason, there is no conceptual or statutory difficulty in allowing transfer of these rights to a

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<sup>370</sup> See 35 Bankr. at 966.

<sup>371</sup> Of course, the lender won't always win. In *In re Barton*, 37 Bankr. 545 (Bankr. E.D. Wash. 1984), the lender was held not to reach PIK entitlements because the original security agreement intentionally omitted any reference to crops or other farm-based collateral. The court held the lender simply did not intend to reach PIK entitlements or other farm-related assets. See *id.* at 547. In *In re Schmidt*, 38 Bankr. 380 (Bankr. D.N.D. 1984), a creditor who had taken farm equipment and other farm assets as collateral was held not entitled to PIK because the security agreement mentioned neither crops nor general intangibles. See *id.* at 383.



secured party. However, most of these rights exist under regulations which require that the assignment be made on a special form and filed in the local ASCS office.<sup>372</sup> In several of the cases discussed above, the party opposing the secured creditor argued that the farmer's failure to make the assignment on the proper form invalidated the creditor's right to reach the payments.<sup>373</sup>

The courts have uniformly rejected this argument. For example, the court in *Nivens* noted that a security interest is not an absolute assignment. The court read the regulation to require the proper form only when there is an absolute assignment.<sup>374</sup> The court further noted that the whole purpose of using and filing these special forms is to make sure the government does not pay the wrong party.<sup>375</sup> Until the form is filed, the government need not recognize the assignment by paying the creditor directly.<sup>376</sup> However, nothing in the regulations suggests that price support funds cannot be used as collateral for crop loans.<sup>377</sup> Thus, it seems that the crop lender need not worry about filling out and filing the proper government forms.

Nevertheless, using the proper forms may be advisable. If the lender anticipates its debtor's participation in one of these programs and takes a formal assignment of the proceeds, it should be entitled to receive the payment directly from the government. Being paid directly is clearly simpler than trying to wrestle the money out of the hands of the insolvent farmer or his trustee.

### 3. *Bankruptcy Preference Issues*

Payments under government price support programs are normally claimed by creditors through preexisting security agreements covering preexisting debts. If they are made during the ninety-day prebankruptcy period, it is possible that they may be preferential under Bankruptcy Code section 547. Under this

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<sup>372</sup> See, e.g., 7 C.F.R. § 770.6(e) (1984).

<sup>373</sup> See, e.g., *In re Nivens*, 22 Bankr. at 290-91; *In re Sunberg*, 729 F.2d at 563.

<sup>374</sup> See 22 Bankr. at 291.

<sup>375</sup> See *id.*

<sup>376</sup> See *id.*

<sup>377</sup> See *id.* For other cases agreeing with this approach, see *In re Sunberg*, 729 F.2d at 563; *In re Kruse*, 35 Bankr. at 964-65; *In re Lee*, 35 Bankr. at 666-67.

section nearly all property acquired by the debtor within the ninety-day period is presumptively preferential.<sup>378</sup>

There is an exception for floating security interests "in inventory or a receivable or the proceeds of either."<sup>379</sup> For this collateral, instead of invalidating all after-acquired property interests, the Bankruptcy Code adopts an improvement of position test. There is a preference only if and to the extent that the creditor improves his position during the ninety-day period.<sup>380</sup> Under section 547(a), farm products, including crops, are "inventory" and are protected by this rule.<sup>381</sup> Payments under price support programs are also protected either as "proceeds" or as "receivables."<sup>382</sup>

If the farmer receives government payments within the ninety-day period and these payments are attached by the creditor's security agreement, it seems obvious that the creditor's position has improved and the payments would be vulnerable. In the two cases where government payments or entitlements appeared during the ninety-day period, however, the creditors were allowed to keep them. Each of these cases approached the problem differently.<sup>383</sup>

In *Nivens*, the preference problem was presented in the context of a cash payment program.<sup>384</sup> Over \$500,000 was owed to two crop lenders at the time bankruptcy was filed, March 18,

<sup>378</sup> The Bankruptcy Code provides that a transfer is not made until the debtor acquires rights in the collateral. Unless new value is given, this means all after-acquired property is acquired and transferred to the creditor pursuant to an antecedent debt. See 11 U.S.C. § 547(e)(3) (1982).

<sup>379</sup> 11 U.S.C. § 547(c)(5) (1982).

<sup>380</sup> For a general discussion of the operation of this provision see J. WHITE & R. SUMMERS, *supra* note 39, at § 24-25.

<sup>381</sup> "'Inventory' means . . . farm products such as crops or livestock, held for sale or lease. . . ." 11 U.S.C. § 547(a) (1982).

<sup>382</sup> 11 U.S.C. § 547(a)(1), (3) provides in part:

(1) 'inventory' means personal property leased or furnished, held for sale or lease, or to be furnished under a contract for sale or lease, or to be furnished under a contract for service, raw materials, work in process, or materials used or consumed in a business, including farm products such as crops or livestock, held for sale or lease; . . .

(3) 'receivable' means right to payment, whether or not such right has been earned by performance. . . .

<sup>383</sup> Compare *In re Nivens*, 22 Bankr. 287, 293-94 with *In re Beattie*, 31 Bankr. 703, 714-15 (Bankr. W.D.N.C. 1983).

<sup>384</sup> See text accompanying notes 318-25, 374-77 *supra*.

1982.<sup>385</sup> As of the ninetieth day before bankruptcy, December 18, 1981, no disaster or deficiency payments had been made. Under the programs, the amounts due could not be determined until after the end of the year because a nationwide average annual price is used as the basis for calculation. The determination of this debtor's entitlement was made on January 27, within ninety days of bankruptcy. Checks totalling \$37,560.75 were then received, some before bankruptcy and some after.<sup>386</sup> Thus, it would seem that the checks received during the ninety-day prebankruptcy period were preferential. At the very least, since the court held these payments were proceeds of the crops, the payments should have been subjected to the improvement-of-position calculus of section 547(c)(5). The trustee adopted the latter approach and contended all of the payments improved the creditor's position.<sup>387</sup>

The court, however, using two separate theories, found no preference.<sup>388</sup> First, the court noted that growing crops undergo continuous change and increase in value constantly from planting until harvest. While this undoubtedly improves the creditor's position, it is not the sort of improvement condemned by section 547(c)(5). There is no new inventory, no "transfer" of property to the creditor which could become preferential.<sup>389</sup> On this point the court seems correct. The natural appreciation in value of a single asset should not be a preference.<sup>390</sup>

But the court did not stop with the increased value of the crop. Instead, it also said the disaster and deficiency payments "cannot be separated from the growing crops,"<sup>391</sup> which seems to equate these payments with the crops' natural increase. It follows, the court reasoned, that the payments created no improvement of position.<sup>392</sup> This conclusion is questionable. Assets may depreciate as well as appreciate; that is always the secured creditor's risk. When the total crop production is lower than expected, there is simply less collateral. Payments under the

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<sup>385</sup> 22 Bankr. at 289.

<sup>386</sup> *See id.* at 293.

<sup>387</sup> *See id.*

<sup>388</sup> *See id.* at 293-94.

<sup>389</sup> *See id.*

<sup>390</sup> *Accord* J. WHITE & R. SUMMERS, *supra* note 39, § 24, at 1010-11.

<sup>391</sup> 22 Bankr. at 294.

<sup>392</sup> *See id.*

programs artificially increase the farmer's assets by taking the place of crops which never grew or a natural appreciation in value which never occurred. This payment is not a natural increase: it is a new asset. When it appears within ninety days of bankruptcy, it is preferential and the crop lender's claim should be tested for improvement of position.

The *Nivens* court also ruled that the debtor's rights under the disaster and deficiency programs "had become fixed"<sup>393</sup> prior to the ninetieth day and, consequently, created no preference. This ruling also seems suspect since both the determination of the amount and the payments were made after the ninetieth day. But the court focused on the overall context of the lending agreement to stretch the time frame. The court said the parties must have contemplated even before planting the possibility "that a disaster might occur which could give rise to the right to disaster payments or low yield payments, and that the final price for the crop could fluctuate to less than the target price, which would give rise to deficiency payments."<sup>394</sup> This analysis is correct. Awareness of the overall context of subsidy programs is the reason the creditor's interest attaches to these proceeds.<sup>395</sup> The court then pointed out that the precise amount of the payments could not be determined until after the crop year.<sup>396</sup> This is also true. However, the court went on to say that the rights to the disaster and deficiency payments became fixed prior to the ninetieth day, and therefore there can be no preference.<sup>397</sup> This is not so obvious.

All floating lienors are aware of and insure against the risks of future contingencies such as destruction of the collateral. In fact, insurance may be provided for in the security agreement. To a certain extent, this fixes in advance of any bankruptcy the right to insurance proceeds. If the court's rationale is followed, the fact that the amount of a loss is determined and the insurance payment is made during the ninety-day prebankruptcy period makes no difference. Such a result is absurd. The insurance payout is clearly a transfer of property within the meaning of

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<sup>393</sup> *Id.*

<sup>394</sup> *Id.* at 293.

<sup>395</sup> See text accompanying notes 318-25 *supra*.

<sup>396</sup> See 22 Bankr. at 293.

<sup>397</sup> See *id.*

section 547.<sup>398</sup> Farm disaster payments, therefore, should be treated as transfers.

Another way around the preference problem was found in *In re Beattie*.<sup>399</sup> Under Bankruptcy Code section 547(c)(5), the creditor's improvement of position is preferential only if it operates "to the prejudice of other creditors holding unsecured claims." In *Beattie*, the FmHA held a security interest in a dairy farmer's farm-related collateral, including crops.<sup>400</sup> Certain milk assignment payments were made during the ninety-day prebankruptcy period, and the trustee attacked them as preferential because they improved the FmHA's position.<sup>401</sup> The court rejected this argument, however, because the assets the FmHA got were encumbered by its own security interest. The court said, "[N]either the debtors' estate nor any unsecured creditors had any anticipation of receiving any part of these proceeds and, thus, the debtors' estate has not been depleted and unsecured creditors have not been denied any assets from the estate."<sup>402</sup> Other courts have also been willing to accept the idea that mere substitution of new security for old does not create a preference since the debtor's estate is not depleted.<sup>403</sup>

Following this rationale, insurance proceeds as well as subsidy payments to secured creditors may be free from attack. Because subsidy payments are designed expressly to be substituted for crop shortages of various types, giving them to the secured creditor does not prejudice unsecured creditors.

A potential preference issue also arose in *Sunberg*.<sup>404</sup> During the ninety-day prebankruptcy period, the debtor signed up and was approved for the PIK program. As discussed above, the court allowed the creditor to reach the PIK entitlements as after-acquired general intangibles.<sup>405</sup> These general intangibles would seem to be covered by the definition of "receivables" in Bankruptcy Code section 547,<sup>406</sup> so the improvement-of-position test

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<sup>398</sup> Cf. 11 U.S.C. § 101(40) (1982) (defines "transfer" in extremely broad terms).

<sup>399</sup> 31 Bankr. 703.

<sup>400</sup> See *id.* at 705.

<sup>401</sup> See *id.* at 714-15.

<sup>402</sup> *Id.* at 714.

<sup>403</sup> See, e.g., *In re Cloyd*, 23 Bankr. 51, 53 (E.D. Tenn. 1982).

<sup>404</sup> 729 F.2d 561 (8th Cir. 1984).

<sup>405</sup> See text accompanying notes 251-54 *supra*.

<sup>406</sup> The definition of "receivable" is quoted in note 382 *supra*.

is still the key. The court avoided this problem, however, by focusing on the fact that the payments were made after bankruptcy.<sup>407</sup> This brings the case within section 552(b) instead of section 547, and the creditor's interest is preserved.

Under the *Nivens* approach, the entitlements in *Sunberg* could be said to have matured during the ninety-day period. This would seem to raise the improvement-of-position question. Even here, however, the estate is not depleted to the prejudice of unsecured creditors, and under *Beattie* there is still no preference. Farm lenders who claim interests in price support proceeds, it seems, have little to fear from the bankruptcy trustee.

### CONCLUSION

While America's farmers may benefit from the myriad federal price support programs, the position of their creditors is not so clear. Creditors who lend to farmers against crops as security expect, like other inventory lenders, to be paid from the proceeds generated by production and sale of the inventory. In times of financial crisis, the creditor also expects to turn to the security. But the operation and complexity of price support programs make the security tenuous in many cases. Much of the problem is caused by inadequacies in the underlying commercial law, particularly the Article Nine special rules for crop and other farm security interests. We believe these special rules should be removed.

We realize there is no gold at the end of the rainbow, and that no amount of changes in Article Nine will solve all the problems. But it would ease them. For example, one is presently forced to analyze complex and strained arguments in order to determine whether a commodity purchase cuts off the secured creditor's rights. The answer ought to be based on the economic and federal policies underlying the program; instead it turns on such irrelevancies as whether the farmer owns his own storage facilities. Simple corrective surgery to Code section 9-307(1) would remedy this problem.

Greater awareness of the farm context and the policies of the government programs could also lead to more sensible read-

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<sup>407</sup> See 729 F.2d at 562.

ings of security agreements and alleviate many problems which arise in the direct payment programs, particularly regarding those instances in which payment is made before the originally intended collateral comes into existence. Again, the creditor's rights to these entitlements in the farmer's hands should be based on the policies of the programs and the needs of the farm community — a community which includes creditors. The legal result in cases where the farmer has not planted should not be different from that in cases where the farmer has planted and then turns the crop under. The approach of the Ohio cases, thus, seems the soundest.

The suggestions made in this Article, we believe, would go a long way toward simplifying the law dealing with farm secured creditors and toward bringing that law into the twentieth century.