AGRICULTURAL FINANCING THROUGH PRODUCTION PAYMENTS: PLANNING FOR PROTECTION OF FARMER AND LENDER

I. INTRODUCTION

The economic depression of the 1930's precipitated the enactment by Congress of legislation designed to stabilize the income of farmers and to bolster farm purchasing power.[1] Since that time, the federal government has consistently administered extensive programs aimed at reducing the oversupply of agricultural commodities and maintaining price levels for farm products.[2] The general policy objective of these programs, which continues to the present, has been to help preserve and maintain the financial integrity of the American farmer through stabilized prices, access to a ready market for crops, and access to sources of financing for seasonal cash-flow needs.[3]

This public policy, at present, is threatened in at least two respects. First, the rapidly declining farm economy jeopardizes the ability of family farmers to continue to farm and remain financially solvent even with the aid of government payments.[4] Second, the courts' interpretations of creditors' rights in the government payments to which farmers are entitled reveal a trend toward restricting the program payments from effectively serving as collateral for farm financing.[5]

Presently the courts, in a majority of cases in which creditors' rights in government payments have been interpreted,[6] have addressed the benefits

---

1. *See* 11 N. HARL, AGRICULTURAL LAW § 91.01 (1984) [hereinafter cited as HARL]. For a summary of such agricultural legislation, see Rasmussen & Baker, *Price Support and Adjustment Programs from 1933 through 1978: A Short History*, U.S. DEP'T OF AGRICULTURE, ECONOMICS, STATISTICS & COOPERATIVE SERVICE, AGRICULTURAL INFORMATION BULLETIN No. 424 (Feb. 1979).

2. *See* HARL, *supra* note 1, § 91.01. Examples of these programs include: marketing quotas and acreage allotments under the Agricultural Adjustment Act of 1938, 7 U.S.C.A. § 1281 (West 1974); parity price supports for various commodities, 7 U.S.C.A. § 1441(a)-(d) (West 1974); and voluntary production control programs, 7 U.S.C.A. §§ 1313-1314 (West 1974).

3. *See generally* HARL, *supra* note 1, §§ 90-91 (for a general discussion of the functions of the Commodity Credit Corporation and federal agricultural commodity programs).

4. *See generally* The Des Moines Register, Jan. 22, 1985, at 2.

5. *See infra* text accompanying notes 45-147.

6. For cases in the PIK context, see Sandage Real Estate, Inc. v. Liebe, 41 Bankr. 965 (Bankr. N.D. Iowa 1984) (bank's perfected security did not extend to farmer's PIK entitlements); Thorp Credit, Inc. v. Fowler, 41 Bankr. 962 (Bankr. N.D. Iowa 1984) (creditor's perfected security did not extend to farmer's PIK entitlements); In re Schmidt, 38 Bankr. 380 (Bankr. D.N.D. 1984) (PIK diversion contract is an executory contract which is characterized as a general intangible under the U.C.C.); Wapakoneta Production Credit v. Cupp, 38 Bankr. 953

to which a farmer was or will become entitled under the federal government's recently codified Payment-In-Kind Program (PIK).[7] Although the recent case law is primarily limited to this context, it may be assumed that the federal government's role in this area, albeit a changing one, is a relatively permanent fixture in the agricultural sector.[8] Even though particular programs may become obsolete, the legal principles now being developed with regard to the respective interests of creditors and farmers will provide important precedent.

This Note will discuss how federal production program payments may be used as collateral under applicable state commercial law. Both the assignment of rights to receive the payments and the perfection of security interests in the payments will be discussed. The courts have only recently been forced to repeatedly consider the issues underlying production payment financing.[9] The recent rapid increase in farm bankruptcies and foreclosures and the resulting scramble of too many creditors for too few assets is undoubtedly a primary reason for this phenomenon.[10] This Note will also con-

---

(Bankr. N.D. Ohio 1984) (payments from PIK are proceeds of the crop and are within the meaning of security agreement); McLemore v. Mid-South Agri-Chemical Corp., 41 Bankr. 369 (Bankr. M.D. Tenn. 1984) (PIK payments constitute proceeds of crop collateral); In re Barton, 37 Bankr. 545 (Bankr. E.D. Wash. 1984) (parties' intent was to exclude crop proceeds and thus PIK payments from security agreement); In re Preisser, 33 Bankr. 65 (Bankr. D. Colo. 1983) (PIK payments included in security agreement covering all crops and proceeds); In re J. Catton Farms, Inc., No. 83-1144, slip op. (Bankr. C.D. Ill. June 7, 1983) (order denying application to incur secured debt); In re Sunberg, 35 Bankr. 777 (Bankr. S.D. Iowa 1983), *aff'd*, 729 F.2d 561 (8th Cir. 1984) (for creditor to claim security interest in PIK bushels, creditor must have had a pre-petition security interest in debtor's general intangibles); In re Kruse, 35 Bankr. 958 (Bankr. D. Kan. 1983) (security interest in crops attaches when crops are planted).

See also Pombo v. Ulrich, 495 F.2d 511 (9th Cir. 1974) (abandonment and target price subsidy payments); In re Jones, 314 F. Supp. 1200 (N.D. Miss. 1970) (cotton price support payments); United States v. Hollie, 42 Bankr. 111 (Bankr. M.D. Ga. 1984) (Milk Diversion Program payments); In re Connelly, 41 Bankr. 217 (Bankr. D. Minn. 1984) (wheat reserve program); First State Bank of Abernathy v. Holder, 22 Bankr. 287 (Bankr. N.D. Tex. 1982) (deficiency and low yield/disaster payments).

7. Regulations covering the basic provisions of the PIK program are codified at 7 C.F.R. § 770 (1984). Interim regulations may be found at 48 Fed. Reg. 1476 (1983) with the final rules appearing at 48 Fed. Reg. 9232 (1983). Under the program, producers are offered a quantity of a commodity as compensation for diverting acreage normally planted with that commodity in addition to that being taken out of production under acreage reduction and diversion programs for 1983. 48 Fed. Reg. 9232 (1983). The positive response to the PIK program was correctly anticipated by the government which initially estimated that the annual effect on the economy would exceed $100 million. *Id.*

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

8. *See supra* notes 1-3. As the programs and sources cited therein suggest, the federal government's role is a pervasive one.

9. *See supra* note 6. The bulk of reported decisions have appeared since 1983.

10. *See generally* The Des Moines Register, Jan. 22, 1985, at 2.

sider potential reforms in the applicable Iowa law as well as practical measures to maximize protection for both the farmer and the lender engaged in the process of financing predicated upon government production payments.

II. Background

A. *Historical Role of Government Programs*

The United States Department of Agriculture has the ultimate responsibility for the administration of all federal farm programs.[11] The Commodity Credit Corporation (CCC), originally created in 1933 as part of the New Deal recovery, is a corporate agency of the federal government operating under the supervision of the Department of Agriculture.[12] The CCC is primarily responsible for the administration of price support and other programs in accordance with its statutorily declared purposes of stabilizing and protecting farm income and prices.[13] With a view toward fulfilling these policy objectives, the federal government's role has changed from the use of "production control programs for many storable basic commodities [consisting] of mandatory acreage allotments and marketing quotas [to] . . . [the enactment of temporary] legislation providing voluntary production controls and new concepts of price support."[14] Present programs are implemented under the authority of the Agricultural Act of 1949[15] as amended by the Agriculture and Food Act of 1981, as amended.[16] These programs, consisting of voluntary acreage limitations, land diversion, set aside, payment-in-kind,

---

11. Exec. Order No. 8219, 4 Fed. Reg. 3565 (1939). This order gave the Secretary of Agriculture exclusive authority previously vested in the President to maintain ownership of the stock of the CCC. *Id.*

12. *See id.*

13. *See* 15 U.S.C.A. § 714 (West 1976). This statutory section provides:

> For the purpose of stabilizing, supporting, and protecting farm income and prices, of assisting in the maintenance of balanced and adequate supplies of agricultural commodities, products thereof, foods, feeds, and fibers (hereinafter collectively referred to as 'agricultural commodities'), and of facilitating the orderly distribution of agricultural commodities, there is hereby created a body corporate to be known as the Commodity Credit Corporation (hereinafter referred to as the 'Corporation'), which shall be an agency and instrumentality of the United States, within the Department of Agriculture, subject to the general supervision and direction of the Secretary of Agriculture (hereinafter referred to as the 'Secretary').

Id.

14. Harl, *supra* note 1, § 91.02.

15. 7 U.S.C.A. § 1421 (West 1976).

16. 7 U.S.C.A. § 1444d (West 1984). The basic provisions for these programs are governed by the Agriculture and Food Act of 1981, 7 U.S.C.A. § 1444d (West 1984), and the Omnibus Budget Reconciliation Act of 1982, Pub. L. No. 97-253, 96 Stat. 768 (1982). The mandatory nature of marketing quotas and acreage allotments has been held a proper exercise of legislative power. *See* Wickard v. Filburn, 317 U.S. 111 (1942); Allen v. David, 334 F.2d 592 (5th Cir. 1964), *cert. denied*, 379 U.S. 967 (1965); Weir v. United States, 310 F.2d 149 (8th Cir. 1962); Trophy v. La Sara Farmers Gin Co., 113 F.2d 350 (5th Cir. 1940).

target prices, price support through non-recourse loans and purchases, and storage programs serve to insulate the market from surplus commodities.[17]

B. *Federal Law*

The threshold question in the examination of farmers' rights to collateralize loans with future federal production payments is whether any federal statute or regulation prohibits this as a method of financing. Two pertinent statutes expressly restrict the assignment of claims against[18] or interests in contracts with[19] the federal government. Section 3727 of title 31 of the United States Code declares "absolutely null and void" the assignment of any claim against the United States unless it is executed in the presence of at least two witnesses and acknowledged by the assignor after the allowance of the claim, the ascertainment of the amount due, and the issuance of a warrant for the payment thereof.[20] Section 15 of title 41 of the United States Code provides that the transfer of a government contract, or any interest therein, "shall cause the annulment of the contract or order transferred, so far as the United States are concerned," but reserves to the government the right to commence an action for breach of the contract.[21] Although, according to their literal terms, the foregoing anti-assignment statutes apply to the assignment of agricultural production benefits, these statutes do not apply to the extent that the rights of an assignee of a particular class of claims are defined by another federal statute.[22] Although the primary purpose of the anti-assignment statutes has been construed with a view toward preventing the federal government from becoming entangled in disputes over entitlement to payment and potential multiple liability, these federal statutes have been interpreted so as not to render unenforceable an otherwise valid assignment between private parties.[23] Therefore, if other

---

17. *See* HARL, *supra* note 1, § 91.03.
18. *See* 31 U.S.C.A. § 3727 (West 1984) (formerly 31 U.S.C. § 203).
19. *See* 41 U.S.C.A. § 15 (West Supp. 1984).
20. *See* 31 U.S.C.A. § 3727 (West 1984).
21. *See* 41 U.S.C.A. § 15 (West Supp. 1984).
22. *See, e.g.*, United States v. Crain, 151 F.2d 606, 608 (8th Cir. 1945), *cert. denied*, 327 U.S. 792 (1946) (suit against the Secretary of Agriculture by assignees of a claim for soil conservation benefits in which 31 U.S.C. § 203 was found not to prohibit assignment of claims to such benefits specifically authorized by a separate federal statute but only to protect against potential double liability of federal government).
23. *See id.* The Eighth Circuit recognized that the statute authorizing assignment of conservation benefits was not negated by the general and anti-assignment legislation since the general statute was enacted for a general policy purpose. *Id.* The court found "there is nothing incongruous in recognizing validity of an assignment of a claim against the government as between the parties, and providing no remedy through the courts to enforce the assignment as against the government, thereby protecting the United States from double liability." *Id. See also* Segal v. Rochelle, 382 U.S. 375, 384 (1966) (assignment of loss-carryback refunds received by bankrupts from federal government given effect as between the parties since broad language of anti-assignment statute "must be interpreted in the light of its purpose to give protection to

federal laws and regulations permit assignment of production benefits, such assignments should be recognized to the extent that they comply with the applicable regulations and so long as assignees do not attempt collection directly from the federal government.

Payments made to farmers under section 8(g) of the Soil Conservation and Domestic Allotment Act[24] are the subject of specific statutory permission for assignment.[25] The Act specifically authorizes the written assignment of payments by producers as security for cash or advances to finance producing a crop, handling or marketing the commodity, or performing a conservation practice.[26] The assignment, however, cannot be used to pay or secure any pre-existing indebtedness.[27] The assignment must be signed by the farmer and witnessed by a member or employee of the County Committee of the Agricultural Stabilization and Conservation Service.[28] The assignment must be filed with the County Committee.[29] The statute also states that the Secretary of Agriculture is not liable if payments are made to a farmer without regard to an assignment.[30] The assignment of PIK benefits is permitted under the attendant regulations if made on the designated form, properly executed by the assignor and assignee, and filed with the local ASCS Committee.[31]

---

the Government").

24. 16 U.S.C.A. § 590a (West 1974). This statute was the original source of acreage allotment payments and provisions for their assignment. Its coverage as to assignments was later extended to payments made under the wheat, feed grain, upland cotton, and rice programs. *See* 7 U.S.C. § 1445b-1(i) (wheat); 7 U.S.C. § 1444d(i) (feed grains); 7 U.S.C. § 1444(g)(16) (upland cotton); 7 U.S.C. § 1444(i)(11) (rice).

25. *See* 16 U.S.C.A. § 590a (West 1974).

26. *See* 16 U.S.C.A. § 590h(g) (West 1974).

27. *See id.*

28. *Id.*

29. *Id.*

30. *Id.* This protects the federal government in a manner similar to the anti-assignment statutes in that the government will not be liable in the event a payment is made to a farmer rather than to his bona fide assignee. *See supra* notes 18-23 and accompanying text.

31. *See* 7 C.F.R. § 770.6(e)-(f) (1984) (the general rules applicable to assignment of payments under 16 U.S.C.A. § 590a); 7 C.F.R. § 709 (1984) (additional regulations promulgated specifically with regard to PIK benefits). The interim rules did not provide for the assignment of PIK payments or for the payment without regard to claims or liens which were applicable to other commodity program benefits. After expiration of the period for public comment, appropriate provisions were added to the rules as follows:

> (e) Assignment with respect to quantities of a commodity which can be received by a producer as payment-in-kind will be recognized by the Department only if such assignment is made on Form CCC-479, Assignment of Payment-In-Kind, executed by the assignor and assignee, and filed with the County Committee.
>
> (f) Except as provided in paragraph (e) in 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.

7 C.F.R. § 770.6(e)-(f) (1984).

The general result under the federal law is that production payments are assignable by following the specified procedures and using the appropriate forms,[32] but only the assignee whose name is on the form has recourse against the federal government.[33] Since the assignment may remain effective as between the private parties,[34] the burden apparently falls upon the lender and the farmer to effectuate the intended and proper assignment.

C. *State Law*

Given the fact that federal law does not preclude the assignment of production payments and that the federal statutes are silent as to the propriety of a security interest in the payments, borrowers and lenders must look to their state's effective Uniform Commercial Code provisions which generally govern all transactions in which a security interest in personal property may be created.[35] The thorniest problem which has generated the most contro-

---

Specific rules for the assignment of PIK payments were later promulgated and appear at title 7, section 709 of the Code of Federal Regulations. 7 C.F.R. § 709 (1984). These regulations provide that PIK payments may be assigned only as security for cash or advances to finance producing a crop, handling or marketing an agricultural commodity, or performing a conservation practice for the current crop year. *Id.* Assignments to secure pre-existing indebtedness are prohibited and "to finance making a crop" is defined to mean "financing the planting, cultivation, or harvesting of the crop including the purchase of equipment and payment of cash rent for the land used and to provide food, clothing, and other necessities required by the producer or persons dependent upon him." *Id.* § 709.3(b). Furthermore, assignment to secure the payment of all or part of the purchase price of a farm or fixed commodity rent is prohibited. *Id.* § 709.3(c). The rules prohibit usurious interest charges on the amount advanced as well as assignment at a discount. *Id.* § 709.5(a)-(b). The regulations also make explicit the limited liability of the Secretary of Agriculture:

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

Id. § 709.8.

32. *See supra* notes 28-31 and accompanying text.

33. *See* 7 C.F.R. § 709.8 (1984). *See supra* note 31.

34. *See supra* note 23 and accompanying text.

35. *See, e.g.*, IOWA CODE § 554.9102 (1983). The Uniform Commercial Code is presently in effect in all jurisdictions except Louisiana. In Iowa, article 9 of the Uniform Commercial Code is codified at section 554.9101-.9507 of the Iowa Code. IOWA CODE §§ 554.9101-.9507 (1983). Reference hereinafter will be to the applicable Iowa Code sections. The Uniform Commercial Code excludes from its coverage a "security interest subject to any statute of the United States to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property." *Id.* § 554.9104(a). The applicable federal statutes govern only the form of assignment and claims against the federal government. *See supra* notes 18-23 and accompanying text. State commercial law provides the basis for the relative rights as between private parties. "Security interest" is defined as "an interest in personal property or fixtures which secures payment or performance of an obligation." IOWA CODE § 554.1201(37) (1983).

versy in court opinions is the classification of the payments into a particular category of collateral under article 9 of the Uniform Commercial Code.[36] If the security interest is sought to be perfected in payments already received—either in cash or in commodities—or in payments yet to be received but for which a farmer has already contracted, the procedure is relatively straight-forward: when both parties consciously intend that the payments serve as collateral for a loan, the Uniform Commercial Code applies and the payments are categorized either as a contract right or as an account.[37] The contract right or account in the context of government programs may be evidenced by letters of entitlement or warehouse receipts.[38]

The more difficult question concerns the creditors' rights to payments not yet received or approved by the federal agency, particularly payments not yet applied for or perhaps even established at the time of the initial security agreement.[39] Since a direct security interest in the benefits is not possible in this situation, the payments under a pre-existing security agreement must be in the form of after-acquired property covered by the terms of the initial security agreement in order for the creditor to have a bona fide claim to the benefits.[40]

Under article 9 of the Uniform Commercial Code, there are at least three possibilities which would result in the classification of the payments as after-acquired property. These include: (1) substituted collateral;[41] (2) proceeds of collateral in which the secured party has a pre-existing security interest;[42] or (3) a general intangible[43] designated in the original agreement

---

36. *See infra* text accompanying notes 41-52.

37. *See* IOWA CODE § 554.9106 (1983). Section 554.9106 defines "account" as "any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance." *Id.*

38. *See* 7 C.F.R. § 770 (1984). Such documents are "documents of title" as defined in section 554.1201(15) of the Iowa Code. IOWA CODE § 554.1201(15) (1983).

39. A pattern in the cases has developed in which the security agreement pre-dates the application by the farmer for government benefits, and, in some cases, pre-dates even the creation by the federal government of the program itself. *See infra* notes 98-146 and accompanying text.

40. *See* IOWA CODE §§ 554.9108, .9204 (1983). The term "after-acquired property" refers generally to collateral acquired by a debtor after the perfection of the security interest. IOWA CODE §§ 554.9108, .9204 (1983).

41. *See, e.g.*, First State Bank of Abernathy v. Holder, 22 Bankr. 287 (Bankr. N.D. Tex. 1982). This is not a statutory category, but one created by judicial decision. *See infra* notes 57-65 and accompanying text. The Uniform Commercial Code defines "collateral" as "the property subject to a security interest. . . ." IOWA CODE § 554.9105(c) (1983). *See generally* Deaner, *Protecting a Lender's Security Interest in PIK Collateral*, 5 J. AGRIC. TAX'N & L. 107 (1983).

42. *See, e.g.*, Pombo v. Ulrich, 495 F.2d 511 (9th Cir. 1974). Section 554.9306 of the Iowa Code establishes the rights of parties to proceeds of secured collateral:

> 1. "Proceeds" include whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds. . . . Money, checks, deposit accounts and the like are "cash proceeds." All other proceeds are "non-cash proceeds."
>
> 2. Except as this article otherwise provides, a security interest continues in col-

as part of the security for the loan when it is subsequently acquired.[44]

III. Case Law

Courts have undertaken a variety of approaches in an effort to remedy the problem of classifying government production payments under the Uniform Commercial Code. Despite the application of various approaches, the nearly universal result has been that secured parties who have properly documented a security interest in the form of after-acquired property prevail to the extent permitted by the applicable bankruptcy laws.[45]

Although the problem of classifying government production payments was addressed in 1972 by the Ninth Circuit Court of Appeals,[46] it was not until ten years later that similar issues began to surface as farmers were increasingly forced into the bankruptcy courts.[47] An accurate prediction as to the classification of government production payments is important in or-

---

lateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.

3. The security interest and proceeds is a continuously perfected security interest if the interest in the original collateral was perfected but it ceases to be a perfected security interest and becomes unperfected 10 days after receipt of the proceeds of the debtor unless:

a. a filed financing statement covers the original collateral and the proceeds are collateral in which a security interest may be perfected by filing in the office or offices where the financing statement has been filed and, if the proceeds are acquired with cash proceeds, the description of collateral in the financing statement indicates the types of property constituting the proceeds; or

b. a filed financing statement covers the original collateral and the proceeds are identifiable cash proceeds; or

c. the security interest in the proceeds is perfected before the expiration of the 10-day period.

Except as provided in this section, a security interest in proceeds can be perfected only by the methods or under the circumstances permitted in this Article for original collateral of the same type.

Iowa Code § 554.9306 (1983).

43. *See, e.g.*, In re Sunberg, 35 Bankr. 777 (Bankr. S.D. Iowa 1983), *aff'd*, 729 F.2d 561 (8th Cir. 1984) (for creditor to claim security interest in PIK bushels, creditor must have had a pre-petition security interest in debtor's general intangibles). Section 554.9106 of the Iowa Code provides: "[g]eneral intangibles means any personal property (including things in action) other than goods, accounts, chattel paper, documents, instruments, and money." Iowa Code § 554.9106 (1983).

44. The ramifications of this classification are important with respect to matters of appropriate filing, perfection of the security interest, and priority of creditors. *See generally* Iowa Code §§ 554.9301-.9408 (1983).

45. *See infra* text accompanying notes 45-146.

46. *See* Pombo v. Ulrich, 495 F.2d 511 (9th Cir. 1974).

47. *See supra* note 6.

der to permit a realistic assessment of farmers' borrowing capacity and creditors' rights. This problem is particularly acute in the bankruptcy context because secured creditors who have properly perfected security interests in property and its proceeds take their share of the secured property free and clear of other creditors if the original collateral became security prior to the filing of the bankruptcy petition.[48] This right, which prevents a creditor from being "cut off" by the filing of a petition in bankruptcy, is commonly referred to as a "pre-petition interest."[49] Therefore, secured creditors are particularly anxious to see government payments classified as after-acquired property or proceeds of collateral documented in a valid pre-petition security interest.

Numerous approaches have been undertaken with a view toward classifying production benefits. As will be discussed below, courts have deemed the payments as rents or profits of real estate, substitutes for crops, proceeds of crops, contract rights, accounts, or general intangibles.[50] These items fall into two basic categories of classification. First, the payments may be classified as property inextricably related to or deriving its existence from crops which the farmer has or would have grown but for the availability of the federal program—rents, profits, substituted crops, and proceeds.[51] Second, the payments have been viewed as distinct from crops, and, therefore, fit the nature of a contract, an account, or a general intangible.[52]

A. *Crop Equivalency Analyses*

In addressing the issues set forth above, the Ninth Circuit Court of Ap-

---

48. *See* 11 U.S.C.A. § 552 (West 1979). The statute, in part, provides:

> (a) Except as provided in subsection (b) of this section, property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.
>
> (b) Except as provided in Sections 363, 506(c), 544, 545, 547, and 548 of this title, if the debtor and a secured party enter into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, product, off-spring, rents, or profits of such property, then such security interest extends to such proceeds, product, off-spring, rents, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable non-bankruptcy law, except to the extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.

Id.

49. "Pre-petition interest" refers to the superior interest of a creditor. *See supra* note 48 and accompanying text.

50. *See infra* text accompanying notes 53-146.

51. *See infra* text accompanying notes 53-94.

52. *See infra* text accompanying notes 94-146.

peals, in the decision of *Pombo v. Ulrich* (*In re Munger*),[53] established a posture which has been implicitly adopted in later court decisions. In *Munger*, a sugar beet farmer elected to abandon his crop in order to participate in a government subsidy payment program which promised to yield a return more favorable than that which would have been yielded by the crop he had abandoned.[54] In the ensuing contest between the farmer's assignee of program benefits and the farmer's lender, (the local Production Credit Association (PCA) which claimed the rights to the payments under a pre-existing security agreement), the court construed the phrase in the original security agreement, describing the collateral as "all crops and proceeds," to include both the abandonment and price subsidy payments, thereby giving the PCA's claim priority.[55] The court explained that this result "assume[d] that the security agreements were drafted with an awareness of the importance of various forms of federal subsidy payments to the realities of financing a farming operation."[56]

Following *Munger*, the crop equivalency approach next appeared in the decision of *First State Bank of Abernathy v. Holder* (*In re Nivens*)[57] wherein a Texas bankruptcy court was faced with competing claims of the trustee in bankruptcy, the local bank which had provided continuous financing, and the Small Business Administration.[58] Each of these parties claimed the rights to the bankrupt farmer's government payments that he had received for his participation in federal deficiency, low yield, and disaster payment programs.[59] Both creditors had properly filed financing statements claiming interests in equipment, crops, livestock, and "all checks and income derived from farming."[60] Although conceding that the payment checks already received were not themselves crops, the court found them to be "at least a substitute for crops or proceeds of those crops."[61] The creditors prevailed on the theory that the payments constituted substituted collateral because the crops in which the creditors did have a valid security interest would have been received or increased had the disaster or low yields not occurred.[62]

A bankrupt farmer's request to permit the assignment of PIK benefits to his lawyer in payment of attorney's fees was rejected in the decision of *In re Preisser*[63] because of a prevailing security interest in favor of the United

53. 495 F.2d 511 (9th Cir. 1974).
54. *See id.* at 512.
55. *Id.* at 513.
56. *Id.*
57. 22 Bankr. 287 (Bankr. N.D. Tex. 1982).
58. *Id.* at 289.
59. *Id.*
60. *Id.*
61. *Id.* at 291.
62. *Id.*
63. 33 Bankr. 65 (Bankr. D. Colo. 1983).

States government covering "rents, issues, and profits" of the debtor's land "and revenues and income therefrom" given to secure a previous, though unrelated, loan from the federal government.[64] Since any grain produced would have constituted rents or profits, the grain from PIK was held by the *Preisser* court to be the equivalent.[65] The court further rejected the debtor's argument that the PIK regulations allowed the payment of benefits only to producers.[66] These restrictions were imposed only for the purpose of administrative convenience and were not to be construed so as to void otherwise valid liens.[67]

The bankruptcy court for the northern district of Ohio in *In re Lee*[68] held PIK payments to be a substitute for crops in which the creditor would have had an interest had the crops been grown.[69] Thus, a security interest given as additional security for a third mortgage on the debtor's hog farm covering "all growing crops . . . [and] proceeds of [their] sale or disposition" created a security interest in favor of the creditor.[70] The *Lee* court dismissed the argument that the PIK contract remained executory at the time of filing of the bankruptcy petition, and, therefore, did not create any rights in favor of creditors.[71] The farmers had argued that since they were not entitled to payments until the passage of the growing season without harvesting crops on the real estate and the planting of a groundcover crop for conservation, the contract was executory.[72] These requirements, however, were found to be promises which were part of the contract terms and not conditions of performance.[73] Thus, the contract was created when the CCC accepted the debtors' bid in the PIK program prior to the filing of the bankruptcy petition.[74]

The same Ohio bankruptcy court recently affirmed this approach in *Wapakoneta Production Credit v. Cupp* (*In re Cupp*).[75] Similar to the situation presented in *Lee*, the *Cupp* decision revealed a situation involving an even more comprehensive security agreement in favor of the local produc-

---

64. *See id.* at 67. This result seems ironic in that the federal government's own prior interest is the reason for the prohibition of the assignment for attorneys fees. *Id.*

65. *See id.*

66. *Id.* The regulations do not mandate such a manner of payment. *See supra* note 31 and accompanying text.

67. *See* In re Preisser, 33 Bankr. at 67.

68. 35 Bankr. 663 (Bankr. N.D. Ohio 1983).

69. *See id.* at 666.

70. *Id.*

71. *Id.* The PIK regulations provide that a participating farmer shall maintain the land removed from production through conservation techniques approved by the USDA. 7 C.F.R. §§ 7701.1-.3 (1984). Failure to comply results in liability of the farmer for the amount of PIK payments made to him as liquidated damages. *Id.* §§ 770.1-.6.

72. *See* In re Lee, 35 Bankr. at 666.

73. *Id.*

74. *Id.*

75. 38 Bankr. 953 (Bankr. N.D. Ohio 1984).

tion credit association which had sought to enjoin the debtors from disposing of PIK payments received.[76] In finding the PIK collateral to be within the scope of the agreement covering operating loans for the preceding five years, the *Cupp* court held that the term "proceeds" must be given a liberal interpretation and "since PIK proceeds are merely substitutes for what the debtor would have grown had the program not come into existence, they are the proceeds of the debtor's business."[77] Since the intent of the parties controls when a contract does not specifically govern a subsequent circumstance, and since the contract in *Cupp* was silent as to the specific contingency of government payments, the court looked to the comprehensive nature of the security described.[78] The *Cupp* court found that the agreement expressed the intent that the creditor was to acquire a security interest in "whatever recompense the [debtor] received as a farmer, regardless of whether it was for having raised crops or for participating in a government subsidy program."[79] In dismissing the argument that the PIK program was not in existence at the time of the security agreement, and, therefore, could not have been within the contemplation of the parties, the court also attributed to the parties the awareness that government programs are, and probably will be, available to the farmer-borrower.[80] Such a distinction would be, according to the court, an artificial one which would "create an unconscionable means by which a farmer could defeat a creditor's security."[81]

Some courts have combined the issue of government production payments as proceeds of crops with that of payments as substitutes for crops.[82] Others have regarded the payments strictly as proceeds.[83]

In the case of *In re Kruse*[84] a bankruptcy court in Kansas specifically held that government entitlement payments, including PIK payments, constituted proceeds of planted crops[85] to the extent that some planted crops were the subject of a security agreement out of which the PIK contract arose.[86] The *Kruse* court specifically rejected the notion that PIK entitle-

---

76. *See id.* at 956. The security agreement covered "crops, both harvested and stored, all similar property and products of crops and proceeds and any contract rights derived from the property together with accounts receivable from such sales." *Id.* at 954.

77. *Id.* at 955.

78. *See id.* at 955-96.

79. *Id.* at 956.

80. *Id.* The *Cupp* court cited the *Munger* decision for the recurring philosophy that parties to a contract involving agriculture-related security are presumed to realize that monies from the federal government are, and will continue to be, available to supplement a farmer's assets. *Id.* (citing Pombo v. Ulrich, 495 F.2d 511 (9th Cir. 1974)).

81. Wapakoneta Production Credit v. Cupp, 38 Bankr. at 956.

82. *See, e.g.*, In re Kruse, 35 Bankr. 958 (Bankr. D. Kan. 1983).

83. *See, e.g.*, McLemore v. Mid-South Agri-Chemical Corp., 41 Bankr. 369 (Bankr. M.D. Tex. 1984).

84. 35 Bankr. 958 (Bankr. D. Kan. 1983).

85. *See id.* at 965.

86. *Id.* at 966.

ments may constitute proceeds of crops which were never planted.[87] Such an agreement might fall under the category of rights in general intangibles as discussed by other courts, but the security agreement in this case did not cover general intangibles or contract rights.[88] Unlike other courts, the "proceeds" analysis undertaken by the *Kruse* court seems to apply only to crops which are planted and subsequently turned under and/or abandoned in order to participate in a government program.[89]

In *McLemore v. Mid-South Agri-Chemical Corp. (In re Judkins)*,[90] a contrary position was taken by a bankruptcy court in Tennessee which held that "PIK entitlements constitute 'proceeds' of crop collateral, even if the crop was never planted."[91] In order to enforce such a security interest, the *Judkins* court found that creditors "must prove a nexus between the PIK entitlements and the original collateral."[92] That is, a security interest in the debtor's corn crop would only entitle the secured party to PIK payments received specifically on account of corn.[93] In *Judkins* a policy argument for the liberal construction of proceeds was again enunciated:

> [A narrower construction] would impair the effectiveness of the subsidy programs because encumbered crops would disqualify participation in federal subsidy programs or produce the anomalous result that the government would eviscerate its own security interest (and the interest of other 'crop' financers) in crop collateral by approving a debtor's participation in subsidy programs. . . . A flexible interpretation of the concept of 'proceeds' promotes responsible management of farming operations by allowing alternatives to grow in crops while simultaneously protecting creditors' security interests.[94]

---

87. *Id.* Accordingly, the PCA was entitled only to the PIK payments to be received for crops that were planted when the bankruptcy petition was filed and which were subsequently turned under, but not to PIK payments received for crops that were never planted pursuant to an agreement with the government not to grow them. *Id.*

88. *See id.*

89. *Compare* In re Kruse, 35 Bankr. 958 (Bankr. D. Kan. 1983) *with* McLemore v. Mid-South Agri-Chemical Corp., 41 Bankr. 269 (Bankr. M.D. Tenn. 1984). *See infra* notes 90-94 and accompanying text.

90. 41 Bankr. 369 (Bankr. M.D. Tenn. 1984) (chemical supplier, as assignee of PIK benefits, had security interest in corn proceeds while Farmer's Home Administration held interest in wheat and proceeds). The court held that a security interest need not have been perfected in real estate to attach to PIK payments and for each creditor to take respective benefits. *Id.* at 373 n.6.

91. *Id.* at 372.

92. *Id.* at 373 n.5.

93. *See id.*

94. *Id.* at 373. A crop equivalency analysis has also been followed in the interpretation of the interest of a secured party (in this case, the federal government, through the FmHA) in a future payment to be received from a private party. *See* In re Cawthorn, 33 Bankr. 119, 120 (Bankr. M.D. Tenn. 1983). Milk production checks were found to be contract rights in which a security interest could be created under the Uniform Commercial Code by perfecting a security interest in farm products and their proceeds. *Id.* at 121. *See also* United States v. Hollie, 42

B. *Accounts or Intangibles Analyses*

The second approach, that of classifying payments apart from their relationship to specific crops, has been followed by courts in at least five jurisdictions including the bankruptcy courts in Iowa.[95] Government production payments in these states are viewed as accounts or general intangibles.[96] If payments are received after the execution of the initial security agreement, the funds and/or commodities may either constitute proceeds of the general intangible or qualify under a generic after-acquired property clause applying to general intangibles.[97]

In the case of *In re Schmidt*,[98] a North Dakota farmer in bankruptcy proceedings sought to have the PIK bushels declared property that was exempt from process, levy, or sale by the bankruptcy trustee on the theory that they constituted crops or grain raised by the debtor, and, thus, were entitled to such an exemption under state law.[99] In *Schmidt*, a security agreement describing the collateral as "[a]ll feed, seed, fertilizer and other supplies now owned or hereafter acquired by debtor for use in connection with its farming operation"[100] did not adequately describe PIK entitlements. Since the term "general intangible" did not appear in the agreement, the court found that the pre-existing agreement did not create a security interest in PIK payments.[101]

In a related context, in which a Minnesota farmer was entitled to grain storage payments to be received from the Commodity Credit Corporation under its wheat reserve program, a bankruptcy judge in *In re Connelly*[102] held that the standard definition of proceeds in the Uniform Commercial

---

Bankr. 111, 119 (Bankr. M.D. Ga. 1984) (security agreement held to cover Milk Diversion Program payments as "farm product, substitutions and additions"); Barrington v. Farmers Home Admin., 34 Bankr. 55 (Bankr. M.D. Fla. 1983) (milk check assignment); Hercules, Inc. v. General Magnetic Tape Co., 434 A.2d 636 (N.J. App. Div. 1981) (custom duty rebates from federal government under 19 U.S.C. § 1313(a) are proceeds of collateral).

95. *See, e.g.*, Thorp Credit v. Fowler, 41 Bankr. 962 (Bankr. N.D. Iowa 1984); Sandage Real Estate, Inc. v. Liebe, 41 Bankr. 965 (Bankr. N.D. Iowa 1984); In re Sunberg, 35 Bankr. 777 (Bankr. S.D. Iowa 1983), *aff'd*, 729 F.2d 561 (8th Cir. 1984). *See also* In re Connelly, 41 Bankr. 217 (Bankr. D. Minn. 1984); In re Schmidt, 38 Bankr. 380 (Bankr. D. N.D. 1984); In re Barton, 38 Bankr. 545 (Bankr. C.D. Wash. 1984); In re J. Catton Farms, Inc., No. 83-1144, slip op. (Bankr. C.D. Ill. June 7, 1983).

96. *See, e.g.*, In re Sunberg, 35 Bankr. at 783.

97. *See id.*

98. 38 Bankr. 380 (Bankr. D. N.D. 1984).

99. *See id.* at 383.

100. *Id.* at 382.

101. *See id.* at 383. Even though no pre-petition interest was found in favor of the creditor, the American Agricultural Credit Corporation, the exemption was not allowed on the basis upon which it was claimed. *Id.* at 384. The state statute allowed an exemption only for crops "raised by the debtor." *Id.* The court found that the PIK bushels could not be exempt because they were not raised by the farmer applying for the exemption. *Id.*

102. 41 Bankr. 217 (Bankr. D. Minn. 1984).

Code was not broad enough to cover payments made on account of grain owned by the farmer which he agreed to keep in storage.[103] A security interest, however, had been established in all accounts or general intangibles, terms which were broad enough to cover the future storage payments.[104] Furthermore, the general intangible came into existence "the moment the grain went into storage and at that instant the bank's security interest in accounts and general intangibles attached."[105] As a result of this definition, the *Connelly* court did not have to affirmatively reach any after-acquired property issues because the property was deemed to be acquired prior to the filing of the bankruptcy petition.[106]

The general intangible analysis was also followed in *In re Barton*,[107] but with strong reservations. Since the PIK program was not in existence at the time the security agreement in *Barton* was executed, intent that the security agreement encompass the proceeds could not logically be ascribed to the parties.[108] Despite the fact that the security agreement in *Barton*, covering a one-and-a-half million dollar operating and consolidation loan from a national finance company, listed general intangibles, accounts, or proceeds, the key factor appears to be that the agreement did not cover any type of crops or their proceeds.[109] The *Barton* court perceived its role as one of balancing the logical intent of the parties against the effects of the PIK program intended by the federal government.[110] Even though the PIK funds were to replace funds otherwise available for crops, the parties apparently did not intend to include crops as part of the security, and, therefore, probably would not have intended to include "items which [stood] in direct substitution of those crops and proceeds."[111]

The bankruptcy courts in Iowa have adopted the position that PIK payments, and presumably other government production payments, constitute contract rights or general intangibles under the Iowa Uniform Commer-

---

103. *Id.* at 220. The farmers also made the argument that since the bank had previously waived its right to the crops which were in storage by executing lien waivers, it thereby waived any right to storage payments received on account of those crops. *Id.* This argument was not further explored because the bank's claim was not framed in terms of proceeds of crops to which it had released its lien, but rather in terms of a general intangible to which it had a prepetition interest. *Id.* This, however, may serve as guidance in the drafting of pleadings and security agreements on behalf of lenders who may have previously released their liens on crops but not specifically on government payments subsequently received on account of those crops. The extent of the released security should be made explicit.

104. *See id.* at 220-21.

105. *Id.* at 221.

106. *Id.*

107. 37 Bankr. 545 (Bankr. E.D. Wash. 1984).

108. *See id.* at 547.

109. *Id.*

110. *Id.*

111. *Id.* The absence of any reference to crops was a conspicuous one in an otherwise comprehensive agreement covering an agriculture operation. *Id.* at 547-48.

cial Code.[112] In the leading case of *In re Sunberg*,[113] a twenty-year, husband and wife, 895 acre farming operation, which had been borrowing money regularly from the local PCA and which was enrolled in PIK, filed for bankruptcy.[114] Principal and interest totalling approximately $450,000 on loans from the PCA were secured by financing statements filed in 1980 and later amended in 1982.[115] Following the deterioration of their financial condition and ultimate bankruptcy, the Sunbergs petitioned the bankruptcy court to permit them to incur secured debt for an operating loan for 1983 expenses from the Farmers Home Administration to be secured by future PIK payments.[116] The PCA objected to the application, claiming a prior interest in the government payments by virtue of its 1980 and 1982 filings.[117] The *Sunberg* court addressed two issues: (1) whether or not it was the parties' intent to include future government subsidies as collateral in the security agreement; and (2) if indeed that was their intent, whether the PIK contract was adequately described to create a security interest under the commercial law of Iowa.[118] As to the first issue, the *Sunberg* court found that the omnibus security clause was very broad, and that given the domination in the agricultural sector of the farm credit system and government subsidies, the parties "would have to be conscious of the impact of the various farm programs in existence *or that might come into existence* on the farmer-borrower's ability to meet his financial obligations."[119] In the absence of evidence to the contrary, the court assumed that such an intent was present and concluded "that the omnibus clause in the parties' security agreement was intended to cover possible future property interests *arising from the government's farm programs and in the last instance, PIK, from the government's largess.*"[120] Given both the broad definition of "proceeds" under the Uniform Commercial Code and the fact that the security agreement covered general intangibles existing or thereafter acquired, the PIK contract in *Sunberg* was governed by the pre-petition rules of bankruptcy law.[121] The Sunbergs were denied permission to make application to the Farmers Home Administration for the loan due to the previous security interest in the PIK payments in favor of the local production credit association.[122] The decision in *Sunberg*

---

112. *See supra* note 95.

113. 35 Bankr. 777 (Bankr. S.D. Iowa 1983), *aff'd*, 729 F.2d 561 (8th Cir. 1984). The Iowa Supreme Court has not yet had an opportunity to confront these issues.

114. *See id.* at 779-80.

115. *Id.* at 779.

116. *Id.* at 778-79.

117. *Id.* at 779.

118. *Id.* at 780-81.

119. *Id.* at 781 (emphasis added).

120. *Id.* (emphasis added).

121. *Id.* at 783. *See also* notes 48-49 and accompanying text regarding the significance of such a pre-petition interest.

122. *See* In re Sunberg, 35 Bankr. at 785.

was affirmed by the Eighth Circuit Court of Appeals which approved the attribution to the parties of knowledge of federal payment programs.[123] In affirming, the appellate court stated: "[t]he parties may not have foreseen the degree of PIK benefits nor the details of the program, but the same can be said of most collateral acquired after a security agreement is entered."[124] Since the rendition of the *Sunberg* decision, two courts have applied the *Sunberg* analysis but with results more favorable to the farmer-debtor.[125]

In *Thorp Credit, Inc. v. Fowler (In re Fowler)*,[126] the creditor-mortgagee's security interest did not extend to PIK entitlements despite the fact that the security agreement was virtually identical to that in *Sunberg*.[127] *Sunberg* was distinguished in *Fowler*, not because of the issues regarding categorization of the PIK payments as collateral covered by the after-acquired property clause in force, but because the chronology of events surrounding the execution of the security agreement — the filing of the bankruptcy petition, and the acceptance of the debtor's PIK application — was somewhat different.[128] In *Fowler*, the farmer's PIK application was accepted over a year following the filing of the bankruptcy petition.[129] By contrast, in *Sunberg* "the Debtors filed their bankruptcy *after* they signed up for and received approval to participate in the PIK program."[130] Thus, in *Fowler* since the property created came into being *after* the bankruptcy petition was filed, no after-acquired property or proceeds analysis was proper and the applicable bankruptcy law severed the creditors' claim to the benefits.[131]

In the recent decision of *Sandage Real Estate v. Liebe (In re Liebe)*,[132] the dispute revolved around a forfeited real estate contract for the purchase of a farm.[133] The contract-buyer in *Liebe* assigned his installment real estate contract to his parents, who subsequently enrolled the farm in the PIK pro-

---

123. *See* In re Sunberg, 729 F.2d 561, 562-63 (8th Cir. 1984).

124. *Id.*

125. *See* Thorp Credit v. Fowler, 41 Bankr. 962 (Bankr. N.D. Iowa 1984); Sandage Real Estate, Inc. v. Liebe, 41 Bankr. 965 (Bankr. N.D. Iowa 1984).

126. 41 Bankr. 962 (Bankr. N.D. Iowa 1984).

127. *See id.* at 963-64. The agreement covered the following property "whether now or hereafter acquired: all accounts, accounts receivable, contract rights, . . . and all other properties including general intangibles." *Id.* at 963. Thorp held a mortgage on the farm as well as a blanket security agreement. *Id.* at 962. The mortgage had already been foreclosed, but a deficiency of nearly $37,000 remained. *Id.*

128. *Id.* at 963-64.

129. *Id.* at 962.

130. *Id.* at 963-64 (citations omitted).

131. *Id.* at 963. In an unreported decision, a bankruptcy court in Illinois has also followed the *Sunberg* type of general intangible analysis. *See* In re J. Catton Farms, Inc., No. 83-1144, slip op. (Bankr. C.D. Ill. 1984) (large-scale farming corporation undergoing reorganization denied permission to incur secured debt; bankruptcy judge's decision being appealed to federal district court).

132. 41 Bankr. 965 (Bankr. N.D. Iowa 1984).

133. *See id.* at 966. Related issues as to ownership of production payments arise when a farm is rented to a tenant. *See, e.g.*, Eberle v. McKeown, 83 S.D. 345, 159 N.W.2d 391 (1969).

gram.[134] Upon nonpayment by the son, the plaintiff-sellers forfeited the real estate contract in accordance with an Iowa statute[135] and claimed that the PIK payments constituted unaccrued rents or profits to which the contract-seller was entitled upon forfeiture.[136] Meanwhile, the local bank which had provided financing for the parents' farming operations over the years claimed a paramount security interest in the PIK entitlements by virtue of a blanket security agreement.[137] The *Liebe* court held that neither the bank nor the contract-sellers had valid interests in the PIK payments.[138] In reference to the bank, the court found that the security agreement did not provide it with rights in any after-acquired property which could be construed to cover the payments.[139] Even though the security agreement did not cover general intangibles, it did cover specific contract rights which had been held in *Sunberg* and other cases to cover PIK payments.[140] Nevertheless, coverage extended only to contract rights in existence at the time of the execution of the security agreement.[141] Since the original security agreement in *Liebe* was dated 1977, there was no such coverage.[142] Furthermore, even if the bank's interest could have somehow covered the PIK payments, the applicable bankruptcy statute would have precluded such an interest because it was not "pre-petition;" that is, the date the PIK entitlements came into existence was not the date of the debtor's application for the program, but the date when the application was approved and signed on behalf of the federal government.[143] That date, in *Liebe*, fell after the filing of the bankruptcy petition, and, therefore, no pre-petition interest was possible.[144] With respect to the contract-seller, the *Liebe* court refused to interpret the concept of rents and profits broadly enough to cover PIK payments because rents and profits are "qualitatively different" from crops which are intimately connected with the real estate.[145] The PIK payments were held personal to the producer and not to the land, and, therefore, the seller was not entitled

134. Sandage Real Estate, Inc. v. Liebe, 41 Bankr. at 966.

135. *See id.* The Iowa Code provides for a summary forfeiture procedure for installment real estate contracts. *See* IOWA CODE ch. 656 (1983).

136. Sandage Real Estate, Inc. v. Liebe, 41 Bankr. at 969. Iowa law provides that a vendor is entitled to unaccrued rents and profits earned by the real estate when the contract is forfeited. *See, e.g.*, Johnson v. Siedel, 178 Iowa 244, 159 N.W. 677 (1916); Hall v. Hall, 150 Iowa 277, 129 N.W. 960 (1911).

137. *See* Sandage Real Estate, Inc. v. Liebe, 41 Bankr. at 967. The court found that the term "hereinafter acquired" applied only to types of collateral preceding the term in the sentence and not to that following. *Id.*

138. *See id.* at 971.

139. *Id.* at 967.

140. *Id.*

141. *See id.* at 966-67.

142. *Id.*

143. *Id.* at 968.

144. *See id.*

145. *Id.* at 970.

to PIK payments under a reversion theory after forfeiture of the real estate contract.[146]

Several conclusions are apparent from the foregoing examination of the case law with respect to the classification of government production payments. First, as the economic resources of farmers become increasingly sparse, the issue of how the courts, particularly in bankruptcy, will treat these payments is one of extreme importance. Second, despite the fact that federal government programs are not immortal,[147] both farmers and lenders may reasonably assume, and indeed may be legally obliged to assume, that the supportive role of the federal government in the agricultural economy will continue. Finally, since security agreements have been interpreted broadly by the courts, government payments are often previously encumbered by the interests of creditors long before the conception of the particular production payment program.

IV. Net Effect - The Problems

It has been estimated that ten to fifteen percent of Iowa farmers will not be able to borrow money for 1985 operations and that one farmer in three may be at the brink of insolvency.[148] While there are a myriad of problems facing the farmer, the problems which inhere under the existing law relative to government payments consist primarily of matters of inconsistency. As demonstrated in the bankruptcy context, the extent to which government production payments are previously encumbered seems to be largely dependent upon the chronological order of execution and filing dates rather than the actual intent of the parties to a security agreement.[149] If a PIK contract, for example, is entered into prior to the filing of the bankruptcy petition, PIK payments subsequently received constitute proceeds of property in which a pre-petition security interest might have been established, and, therefore, are not subject to the claims of other creditors of the bankrupt estate.[150] On the other hand, if the PIK contract is entered into after the filing of the petition, the previous creditors do not take their share free of other interests.[151] This seems to be an anomalous result dictated in large part by random factors in addition to the availability of government programs as opposed to the reasonable expectations of the parties to the

---

146. *Id.* at 970-71. Even if the PIK payments had been construed to fall within the rents and profits concept, the contract-seller had not met its burden of proof that the right to the entitlements accrued after the forfeiture and reversion of possession of the property. *Id.* at 971.

147. Indicative of the uncertainty over the continued existence of federal programs is Secretary of Agriculture Block's recent announcement of the intent, but not the details, of a plan to phase out farm subsidies by 1987. The Des Moines Register, Dec. 3, 1984, at 1, col. 6.

148. The Des Moines Register, Jan. 22, 1985, at 2, cols. 2 & 5.

149. *See supra* notes 113-46 and accompanying text.

150. *See supra* notes 113-24 and accompanying text.

151. *See supra* notes 125-46 and accompanying text.

initial contract.

Lenders consistently prevail, primarily on the theory that both farmers and their creditors are charged with knowledge of the federal government's pervasive involvement in the financing of agriculture and that such payments are so common that their subsequent creation is to be reasonably expected.[152] At the same time there is evidence that lenders have been discouraged from lending to farmers, in part, because of the uncertainty surrounding security for such a credit extension.[153] The subsequent availability of a government program for non-production should not provide the mechanism by which a lender with a security interest in crops or their proceeds is suddenly left unsecured upon the farmer's business decision to participate in a federal non-production program rather than plant and harvest the crop.[154]

The ultimate result, however, appears to be purely that of a windfall for lenders who, in effect, are receiving additional liquid security on the coat tails of what is at best an omnibus clause in a boilerplate contract. Farmers cannot be expected to be clairvoyant as to future government action. And if the borrower or lender erroneously assumes the existence of continued government financial assistance, how are those apparently reasonable expectations protected when the government programs disappear? It would seem that such contingencies should only be recognized when specifically included as part of the initial transaction.

Furthermore, uncertainty derived from the windfall effect places unanticipated limits on the farmer's borrowing capacity and results in a basic inconsistency with the policy objectives of federal farm support programs, that is, to increase stability and cash flow potential. Concededly parties should be free to determine the collateral for their transactions, but the windfall element should be minimized.

---

152. *See supra* text accompanying note 124 (Eighth Circuit Court of Appeals' philosophy expressed in its affirmance of *Sunberg*).

153. Although in a somewhat different context, the general philosophy has been aptly expressed as follows:

> A mere change in farming operations should not alone divest a secured creditor of collateral which otherwise unequivocally secured the creditor's claim. A conclusion to the contrary would have the potential to disrupt routine financing arrangements on a large scale, and also would encourage debtors to change their mode of operation for the sole tactical purpose of divesting creditors of collateral.

Fairchild v. Lebanon Prod. Credit Ass'n, 31 Bankr. 789, 793 (Bankr. S.D. Ohio 1983) (court denied debtor's claim that conversion from hog feeding to hog breeding operation was outside scope of ordinary business operations and thus not subject to coverage of after-acquired property clause).

154. *See* The Des Moines Register, Jan. 22, 1985, at 2, cols. 4 & 5. Some day-to-day relationships between farmers and lenders in this regard may approach the essence of an adhesion contract, and, thus, present an opportunity to argue that security agreements such as those discussed above should be construed in accordance with applicable contract principles, that is, most strongly against the drafter or provider of the form agreement, here, the lender.

V. Proposals

It has been said that the solution to the farm credit problem lies primarily at the federal level.[155] Nevertheless, states have the ability to effect some changes in the area to bring relief.

Given the realities of farmer/lender relations, it is unlikely that farmers will be in a position to insist upon detailed clarification of the security described in the routine, annual operating loan security agreement. Although no contract may ever be expected to address all potential contingencies, some proposals aimed primarily at achieving uniformity and notice are constructive.

As to security agreements presently on file, the simplest solution appears to be that farmers and lenders should consider filing supplemental or amended security agreements specifying the inclusion or exclusion of specific government production payments as collateral.[156] Parties who intend for such payments to be included as part of the collateral should also review their compliance with the applicable federal regulations if it is intended that the secured party receive the payments directly from the federal government.[157]

The most comprehensive reform would be the adoption, as part of the Uniform Commercial Code, of a statute specifically applicable to the creation and perfection of security interests in government production payments. Assignment of the payments and security interests therein should be recognized only when there is some specific expression in the agreement of intent by the parties that the payments serve as collateral. The use of generic clauses, such as "accounts" or "general intangibles," covering security should, by definition under the statute, be inadequate for the automatic cre-

---

155. *Id.*, cols. 2 & 3.

156. Amendments are presently filed in an identical manner as the original agreements, but if the amendment adds collateral, it is effective as to the added collateral only from the filing date of the amendment. *See* Iowa Code § 554.9402 (1983). When a conscious effort is made to describe government payments, accurate and complete description is obviously desirable. In its discussion of "proceeds," the court in *Pombo v. Ulrich* held that the test of sufficiency of a description of collateral was "whether it would indicate to an interested third party the possible existence of prior encumbrances on the collateral." Pombo v. Ulrich, 495 F.2d 511, 512 (9th Cir. 1974). *See supra* text accompanying notes 53-56. The Uniform Commercial Code provides a statutory test for sufficiency of the description: any description of personal property is sufficient for purposes of article 9 if it "reasonably identifies what is described." Iowa Code § 554.9110 (1983). *See also* Koehring Co. v. Nolden, 27 Bankr. 167, 169 (9th Cir. 1983) ("filing statement must be 'marginally sufficient' despite the error, in order for the error to be deemed 'not seriously misleading' "); In re Frieze, 32 Bankr. 194 (Bankr. W.D. Mo. 1983) (cash proceeds from sale of crop not covered because "proceeds box" not checked on pre-printed security agreement).

157. *See supra* notes 24-31 and accompanying text. *See also* In re Jones, 314 F. Supp. 1200 (N.D. Miss. 1970) (father farmed bankrupt son's land for which son had applied for cotton price support payments without proper assignment to father; local ASCS committee's finding that father equitably entitled to payments was determinative).

ation of a security interest in government payments. Furthermore, it should be a statutory condition that any production payment which is to be the subject of a security interest must at least be in existence at the time of the execution of the security agreement.

Perhaps a starting point for such legislative reform should include: (1) the amendment of section 554.9106 of the Iowa Code[158] to separately define "government payments" as a form of intangible property including cash or other value received from an agency of the federal or state government in connection with a farming business; and (2) the amendment of section 554.9402 of the Iowa Code[159] to provide that financing statements covering government payments must reveal the farming property or business to which the amendment applies and the present or future programs within its coverage. Additionally, such financing statements would apply to government programs which are not currently in force at the time of the execution of the financing statement.[160]

VI. Conclusion

The proliferation of differing judicial results in the field of government agricultural production payments conflicts with the principal goal of the Uniform Commercial Code — uniformity in commercial transactions. This inconsistency also denies farmers full credit for the use of federal payments as collateral, contrary to the general federal policy regarding agricultural programs. Rather than relying on the courts' case-by-case determination, the Code should now be amended to permit parties to carefully and accurately craft their own security arrangements with regard to these payments.

Barbara A. Whitaker

---

158. Iowa Code § 554.9106 (1983). The statutory definition of "general intangibles" currently covers "any personal property (including things in action) other than goods, accounts, chattel paper, documents, instruments and money." *Id.*

159. Iowa Code § 554.9402 (1983). Such an amendment would be similar to subsection 5, which lists details which must be included in financing statements "covering timber to be cut or . . . minerals or the like." *Id.* This added provision would be specifically addressed to financing statements covering farm property.

160. Further provisions in section 554.9402 might be made to permit: (1) the use of an escrow account for the deposit, for the benefit of the secured party of the government program payment funds received; and (2) centralized filing of all security agreements purporting to cover production payments.