

In the United States Bankruptcy Court

for the Northern District of Iowa

JOSEPH M. PUETZ and
KARLA PUETZ
Debtor(s).

Bankruptcy No. X87-00178S

Chapter 7

ORDER RE: MOTION TO DETERMINE SECURED STATUS

The matter before the court is a motion to determine secured status filed by Farmers Home Administration. Trustee Edward F. Samore has filed a resistance to the motion to determine secured status. A hearing was held on July 6, 1988. The court now states its findings of fact and conclusions of law pursuant to Bankr. R. 7052. This is a core proceeding under 28 U.S.C. § 157(b)(2)(B).

FINDINGS OF FACTS

This case was submitted to the bankruptcy court on stipulated facts. The parties stipulate to the following facts which the court adopts as its findings:

1. The Trustee, Edward F. Samore, pursuant to a Stipulation signed by Judge Melloy on April 26, 1988, sold Commodity Certificate No. 19-161-0 to Cargill, Inc. for approximately \$3,050.07.
2. The Trustee, Edward F. Samore, came into possession of this property as a result of the filing of the bankruptcy in the case of Joseph M. and Karla Puetz, Bk. No. X-87-00178S. As a result of the bankruptcy, the debtors turned over to the Trustee certain assets as a result of their Chapter 7 liquidation.
3. The Commodity Certificate or Payment in Kind Certificate (PIK Certificate) is an asset that was turned over to the trustee.
4. The debtors, Joseph and Karla Puetz, were enrolled in the 1986 United States Department of Agriculture Farm Program. Under the Program, producers received deficiency payments for compliance with certain requirements, such as reducing crop acreage. Some of the program payments are made in the form of negotiable certificates that can be redeemed in commodities or cash. This is the type of certificate referred to as a PIK Certificate.
5. This PIK Certificate is in payment of a portion of the debtors' 1986 deficiency payment.
6. FmHA claims a perfected security interest in the debtors' 1986 deficiency payments by virtue of a promissory note signed by the debtors on March 8, 1985, a security agreement dated August 20, 1986 and by virtue of financing statements filed January 28, 1985 and amended September 17, 1986

The parties also submitted stipulated exhibits to the court which included the promissory note, security agreement, and the two financing statements provided to Farmers Home Administration by the debtors. Additionally, the commodity certificate was submitted as an exhibit to the court.

DISCUSSION

The issue before this court is whether the FmHA has a valid security interest in the proceeds of a generic commodity certificate which are being held by the trustee.

The trustee argues that FmHA did not have a valid security interest in the commodity certificate and therefore is not entitled to the proceeds. The trustee relies on 7 C.F.R. § 770.6 and the reasoning of In re Halls, 79 B.R. 417 (Bankr. S.D. Iowa 1987). The court in Halls held that PIK certificates cannot be encumbered based on federal regulations contained in 7 C.F.R. § 770.6. 7 C.F.R. § 770.6 provides:

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

The court in Halls at 420 reasoned that the certificate shall not be subject to encumbrances in order to allow for ease of transferability.

The FmHA contends that it has a valid security interest in the proceeds of the commodity certificate since it properly perfected a security interest in the 1986 deficiency payments. FmHA argues that the court in Halls failed to recognize a change between the initial regulations as promulgated and the regulations in their final form and the significance of the change. FmHA's brief at 2. FmHA believes that the purpose of the regulation is to guide the relationship between the CCC and its clients, rather than to eliminate valid security interests under state law.

The FmHA also argues that the regulations concerning the assignment of PIK certificates specifically exempts agencies of the federal government, including the Farmers Home Administration. 7 C.F.R. § 770.4(b)(2) provides:

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

ASCS deficiency payments are paid to farmers when the average market price for a particular commodity falls below a target price set by the government. In 1986, the debtors received corn deficiency payments in which part of the payments were made in commodity certificates. The ASCS makes some deficiency payments in the form of commodity certificates rather than cash. See 7 C.F.R. § 770.2.

A review of the jointly filed exhibits indicates that the FMHA perfected its alleged security interest in the deficiency payments pursuant to Iowa law. The financing statement filed with the Secretary of State on January 28, 1985 provided that the FMHA has a security interest in crops including proceeds and products thereof. The FMHA filed an amendment to the financing statement on September 17, 1986. The amendment provided that the FMHA has a security interest in accounts and contract payments including government program payments, warehouse receipts, and rental payments.

FMHA appears to have a valid security interest in the 1986 deficiency payments under Iowa law. However, it is also necessary to determine whether federal laws prohibit the assignment of government payments, thereby extinguishing a valid security interest under state law.

The subject commodity certificate was given to the debtors in payment of their 1986 deficiency payments. Under current farm programs, the government may make deficiency payments either in the form of cash or commodity certificates. 7 C.F.R. § 770.2.

The provisions of the farm program for feed grain crops is set forth in 7 U.S.C. § 1444e. 7 U.S.C. § 1444e(k) provides:

"The provisions of § 590h(g) of Title 16 relating to assignment of payments (shall apply to payments under this section)."

Section 590h(g) provides:

"A payment which may be made to a farmer under this section, may be assigned, without discount, by him in writing as security for cash or advances to finance making a crop, handling or marketing an agricultural commodity, or performing a conservation practice. Such assignment shall be signed by the farmer and witnessed by a member of the county committee or by an employee of such committee, except that where the assignee is a bank whose deposits are insured by the Federal Deposit Insurance Corporation, the Farmers Home Administration, or a Production Credit Association supervised by the Farm Credit Administration, such assignment may be witnessed by a bonded officer of the lending institution. Such assignment shall be filed with the county committee. Such assignment shall not be made to pay or secure any pre-existing indebtedness. This provision shall not authorize any suit against or impose any liability upon the secretary or any disbursing agent if payment to the farmer is made without regard to the existence of any such assignment. The secretary shall prescribe such regulations as he determines necessary to carry out the provisions of this section."

Based on current federal law and regulations, it is important to determine whether the assignment of the 1986 deficiency payments was made to secure any pre-existing indebtedness in order to determine the validity of FmHA's security interest in the commodity certificate. From a review of the exhibits submitted to this court, it appears that the Farmers Home Administration loaned money to the debtors only in 1985. There is no indication that FMHA extended any new credit to the debtors in order to permit them to finance the making of a crop for 1986 or that the 1985 loan was for the making of a crop. The promissory note granted to Farmers Home Administration indicates that a loan was extended to the debtors in March, 1985. It appears that the assignment of the 1986 deficiency payments was made to secure the promissory note granted in 1985, which was a pre-existing indebtedness. Therefore, the assignment of the 1986 deficiency payments was contrary to the anti-assignment provisions set forth in 16 U.S.C. § 590h(g).

Regulations adopted pursuant to 16 U.S.C. § 590h(g) are provided for in 7 C.F.R. Part 709. 7 C.F.R. § 709.3(a) provides,

"A payment which may be made to a producer under any program to which this part is applicable may be assigned only as security for cash or advances to finance making a crop, handling or marketing an agricultural commodity, or performing a conservation

practice, for the current crop year. No assignment may be made to secure or pay any pre-existing indebtedness of any nature whatsoever.

This court must decide whether 16 U.S.C. § 590h(g) and the applicable regulations were intended to pre-empt state laws regarding security interests.

The court stated in J. Catton Farms v. First National Bank of Chicago, 779 F.2d 1242, 1246 (7th Cir. 1985), "[t]he purpose [of 16 U.S.C. § 590h(g)] is to make sure the intended beneficiary of federal largess retains the benefit."

The purpose of 11 U.S.C. § 590h(g) was explained in a 1952 Senate Report. The Secretary of Agriculture noted in a letter to the President of the Senate in January, 1952, that § 8(g) [amended as 16 U.S.C. § 590h(g)] "was enacted for the purpose of creating additional credit to farmers to assist them in financing farming operations." S. Rep. No. 1305, 82d Cong., 2d Sess., 3, cited in Barlow v. Collins, 397 U.S. 159, 165, n. 7 (1970). See also In re Bechtold, 54 B.R. 318, 321 (Bankr. D. Minn. 1985); In re Azalea Farms, 68 B.R. 32, 34 (Bankr. M.D. Fla. 1986); In re Halls, 79 B.R. 417, 419 (Bankr. S.D. Iowa 1987).

The provisions of 16 U.S.C. § 590h(g) specifically states that "Assignment shall not be made to pay or secure any pre-existing indebtedness." This language supports the reasoning that this section was enacted in order to provide additional credit to farmers that could be used to continue their operations. A recent decision by a Kansas bankruptcy court has concluded that the plain language of 16 U.S.C. § 590h(g) may be applicable to an assignment given as security. In re Holman, 85 B.R. 869, 871 (Bankr. D. Kan. 1988). However, the court determined that the security interest would not be invalidated since there was no preexisting indebtedness involved. Id.

In this case, the 1986 deficiency payments were assigned by Puetz to secure a pre-existing indebtedness. The debtors borrowed operating capital from the FmHA on March 8, 1985. There was no security agreement signed by the debtors for this loan until August 20, 1986. A security interest is not enforceable against the debtor or third parties unless the debtor has signed a security agreement. Iowa Code § 554.9203(1)(a). Therefore, the debt was unsecured between the period of March 8, 1985 and August 20, 1986.

The assignment of the security interest in the deficiency payments did not take effect until the security agreement was signed on August 20, 1986. FmHA did not extend any new credit to the debtors on August 20, 1986. Therefore, the ASCS payments were assigned to secure a pre-existing indebtedness which is prohibited by 16 U.S.C. § 590h(g).

The court agrees that a commodity certificate can be assigned in some situations. See In re Arnold, Bankr. No. 87-00767W, slip op. (Bankr. N.D. Iowa, July 8, 1988). However, this court believes that the provisions of 16 U.S.C. § 590h(g) preclude the assignment of the subject commodity certificate since it was assigned to secure a pre-existing indebtedness.

ORDER

IT IS THEREFORE ORDERED that the FmHA does not possess a valid security interest in the proceeds of the commodity certificate.

SO ORDERED THIS 6th DAY OF OCTOBER, 1988.

William L. Edmonds
Chief Bankruptcy Judge