In the United States Bankruptcy Court

for the Northern District of Iowa

GARLAND G. SMITH and CONNIE E. SMITH	Bankruptcy No. X92-00204F
Debtors.	Chapter 7

ORDER RE: MOTION FOR COMPROMISE OR SETTLEMENT OF CONTROVERSY

The matter before the court is the trustee's Motion for Compromise or Settlement of Controversy. Hearing on the matter was held January 21, 1993 in Fort Dodge, Iowa. The trustee has received $7,039.00 which was paid to the debtors as disaster payments under a federal agriculture program for their 1991 crop. The Rolfe State Bank claims it is entitled to these payments as part of its secured claim. The trustee disputes the bank's security interest in the disaster payments and seeks to compromise the matter by distributing $6,500.00 to the bank and retaining $539.00 for the estate.

The Smiths object to the proposed compromise on the ground that the payments are not property of the estate. The Smiths argue that they became eligible for the payments only after signing up and qualifying for them during February and March of 1992. The Smiths filed their bankruptcy petition on January 31, 1992.

Property of the estate is broadly defined under 541(a) of the Bankruptcy Code to include:

> All legal or equitable interests of the debtor in property as of the commencement of the case.

11 U.S.C. 541(a)(1). The court concludes that the Smiths had a property interest in the disaster payments as of the date of the filing of their bankruptcy petition. The Smiths claim that their property interest in the disaster payments was created only after signing up for the payments and qualifying for them by such activity as verifying their crop yields. The trustee argues that the entitlement arose out of pre-petition activity such as planting and harvesting the 1991 crop. Post-petition activity may have made the Smiths' claim against the government a liquidated and matured claim. However, pre-petition events created a property interest that became property of the estate on the date of filing.

Several cases discussing setoff rights have found that enactment of an appropriations bill triggers a debtor's right to payments under disaster programs. In In re Stephenson, 84 B.R. 74 (Bankr. N.D. Texas 1988), the court held that supplemental disaster payments were not subject to offset because the Chapter 12 debtor's claim for payments arose at the time Congress authorized funding post-petition. And see, In re Thomas, 93 B.R. 475, modifying 91 B.R. 731 (N.D. Texas 1988), which involved the same disaster program and similar facts as Stephenson in a chapter 7 case. The court in Thomas also held that the supplemental disaster payments were not property of the estate because the appropriations act was post-petition. In In re Young, 144 B.R. 45 (Bankr. N.D. Texas 1992), the debtors filed a chapter 7 petition on November 22, 1991. The Food, Agriculture, Conservation & Trade Act of 1990 (FACT Act), Pub.L. 101-6241 104 Stat. 3967, passed November 28, 1990, provided that the Secretary of Agriculture could authorize disaster payments for farmers for the crop

years 1989 or 1990. The court in Young stated that the FACT Act required congressional appropriation of funds for the disaster payments before any benefits under the program would be provided. Id. at 46. Enactment of the appropriations bill created the entitlement. In the Young case, the enactment was post-petition, and no setoff was allowed.

The court finds that the enactment of the appropriations bill on December 12, 1991, was the final event which gave the Smiths a property interest in the disaster payments. See Pub.L. 102-229, 105 Stat. 1712, Dec. 12, 1991, amended by Pub. L.

102-368, 106 Stat. 1130, Sept. 23, 1992 (Dire Emergency Supplemental Appropriations Act of 1992). The appropriations bill was enacted pre-petition. Therefore, the Smiths' interest in the disaster payments is property of the estate.

The court next must determine whether to approve the trustee's proposed compromise, considering the following factors:

(1) the probability of the success of the litigation on its merits;

(2) difficulties which might arise in collecting any judgment;

(3) the complexity of the litigation and its attendant

expense, inconvenience and delay; and

(4) the paramount interest of the creditors with due deference to their reasonable views.

Drexel v. Loomis, 35 F.2d 800, 806 (8th Cir. 1929); In re Hermitage Inn, Inc., 66 B.R. 71, 72 (Bankr. D. Colo. 1986). In order to approve the settlement, the bankruptcy court need not determine that this is the best settlement that can be obtained. Rather, the court must decide whether the settlement "fall (s) below the lowest point in the range of reasonableness." In re W. T. Grant Co., 699 F.2d 599, 613 (2d Cir. 1983), cert. denied sub nom Cosoff v. Rodman, 464 U.S. 822, 104 S.Ct. 89 (1983), citing Newman v. Stein, 464 F.2d 689, 693 (2d Cir. 1972), cert. denied sub nom Benson v. Newman, 409 U.S. 1039, 93 S.Ct. 521 (1972).

The most significant of the above factors in this case is the first, the trustee's probability of success on the merits if the issues were litigated. The trustee's proposed compromise is reasonable if it provides a benefit to the estate. Because the trustee proposes to distribute most of the disaster program receipts to the Rolfe State Bank, the compromise is reasonable if the bank has a strong probability of showing a security interest in the disaster payments that survived bankruptcy. Therefore, the court must examine the bank's security interest in the disaster payments.

The security agreement between Rolfe State Bank and the Smiths, dated March 19, 1990, grants the bank a security interest in, among other things, all farm products, the corn and soybean crops for 1990, 1991 and 1992, accounts and other rights to payment of money, and general intangibles. The agreement also covers after-acquired property. The following language was typed in as an addition to the form agreement:

> Debtor assigns his interest in and to all proceeds or commodities paid to the debtor by the U. S. Government under various farm programs in which debtor is a participant.

This language shows that the parties intended to create a security interest in rights to payment under government farm programs such as the disaster payments.

On February 22, 1977, the bank filed a financing statement with the Iowa Secretary of State covering the following property:

> all farm products, including but not limited to crops ... whether now or hereinafter existing or acquired; all contract rights, chattel paper, documents, and accounts, whether now or hereafter existing or acquired including proceeds from sale hereof.

The parties do not dispute that the bank properly filed a continuation statement, and agree that the bank is perfected in the property listed in the financing statement. The issue, then, is whether the description in the financing statement is sufficient to cover the disaster payments.

A collateral description in a financing statement is sufficient if it "contains a statement indicating the types, or describing the items, of collateral." Iowa Code 554.9402(l) (1992). The purpose of the financing statement is to put other creditors on notice that the filing creditor may have a security interest in a type of collateral. Since the financing statement need not identify the collateral particularly, creditors may need to inquire further about the specific collateral covered. Merchants National Bank v. Halberstadt, 425 N.W.2d 429 (Iowa App. 1988) (citations omitted). A description of a security interest in personal property must reasonably identify what is described. Iowa Code 554.9110 (1992). "The test of the sufficiency of a description is that the description does the job assigned to it--that it makes possible the identification of the thing described." Id., citing First State Bank of Nora Springs v. Waychus, 183 N.W.2d 728, 730 (Iowa 1971); Lisbon Bank & Trust v. Commodity Credit Corp., 679 F.Supp. 903 (N.D. Iowa 1987).

The bank claims a security interest in the payments either as proceeds of crops or as contract rights.

> "Proceeds" include whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds.

Iowa Code 554.9306(l) (1992). In In re Kingsley, 865 F.2d 975 (8th Cir. 1989), the court interpreted the North Dakota statute identical to Iowa Code 554.9306(l) and held that payments from diversion and deficiency programs were not crop proceeds. Payments from these programs do not fit the definition of proceeds. The diversion payments in Kingsley were not proceeds because there was no crop, and the deficiency payments were not received "upon the sale, exchange or other disposition" of the crops. Rather, the court found the payments were general intangibles or contract rights.

Each government program has different features and must be analyzed separately. Kingsley, 729 F.2d at 978; In re Kruger, 78 B.R. 538, 539 (Bankr. C.D. Ill. 1987). However, the Kingsley analysis would apply equally to disaster program payments. The court in Kingsley refused to broaden the term "proceeds" to include crop "substitutes" which are meant to provide the farmer a minimum return on the crop. Kingsley, 729 F.2d at 980. Cf. In re Kruse, 35 B.R. 958, 965 (Bankr. D. Kan. 1983) ("low yield/ disaster payments made to supplement a planted crop" are crop proceeds).

The court in In re Ladd, 106 B.R. 174 (Bankr. C.D. Ill. 1989), determined that disaster payments do not come within the definition of proceeds, applying a three-part test:

1. A crop must be planted;

2. There must be a disposition of the crop.

3. The entitlement which the secured creditor is claiming must have been received in connection with that disposition.

Ladd, 106 B.R. at 176, citing In re Kruger, 78 B.R. 538 (Bankr.

C.D. Ill. 1987). The court stated:

> These payments are made to compensate a farmer for any deficiency brought about by drought, hail, excessive moisture, or related conditions in 1988. The payment is based upon historical yields for the acreage involved times a particular percentage. A farmer can have a bad year (because as in this case the drought of 1988) and still receive the payment even though the crop s never harvested, or, if harvested, is kept by the farmer. The payment is calculated on an estimated, not on actual, yield. There is no requirement that a farmer sell or otherwise dispose of his crop in order to be entitled to a disaster payment. But there has to be a sale, exchange, collection or other disposition in order for something to be received in its place and thereby fall within the classification of proceeds. In this case the disaster payments would have been received regardless of whether there was a sale or other disposition. They were not received as a substitute for a disposed-of crop.

Ladd, 106 B.R. at 176-77. The court concluded the security interest should have been perfected as a general intangible. Id. at 177.

The holding in Ladd is consistent with the Eighth Circuit's unwillingness to expand the definition of "proceeds" beyond the language of UCC 9-306. See Kingsley, 865 F.2d at 980. This court concludes that Rolfe State Bank does not have a security interest in the disaster payments as crop proceeds.

The bank also claims it has a security interest in the disaster payments as "contract rights," which derive from the original contract that the Smiths made with the ASCS to enroll in the farm program. The 1972 revisions to the UCC, adopted by Iowa in 1974, deleted the term "contract rights" from Sec. 9106. The UCC term for contractual rights to farm program benefits is "general intangibles." In re Hunerdosse, 85 B.R. 999, 1005 (Bankr. S.D. Iowa 1988), citing In re Sunberg, 35 B.R. 777, 781 (Bankr. S.D. Iowa 1983) aff'd 729 F.2d 561 (8th Cir. 1984). Iowa Code 554.9106 defines "general intangibles" to include:

> any personal property (including things in action) other than goods, accounts, chattel paper, documents, instruments, and money.

The Official Comment to Iowa Code 554.9106 states:

> The term "general intangibles" brings under (Article 9] miscellaneous types of contractual rights and other personal property which are used or may become customarily used as commercial security.

The deletion of "contract rights" from UCC 9-106 was not a substantive change. Lisbon Bank & Trust Co. v. Commodity Credit Corp., 679 F.Supp. 903 (N.D. Iowa 1987). A security interest in contract

rights still covers contractual rights under farm subsidy programs because a contract right is a specific type of intangible. Sunberg, 35 B.R. at 782; In re Heims, 65 B.R. 112 (Bankr. N.D. Iowa 1986).

A number of cases have held that a security interest in "contract rights" covered rights under government farm programs. Sunberg, 35 B.R. 777, (Bankr. N.D. Iowa 1983); aff'd 729 F.2d 561 (8th Cir. 1984) (rights under PIK program); In re Liebe, 41 B.R. 965 (Bankr. N.D. Iowa 1984) (same; however, terms of contract made rights effective post-petition); Bank of Cresbard v. Lindhorst Farms, Inc., 78 B.R. 1002 (D. S.D. 1987) (deficiency and diversion payments and PIK drafts were either contract rights or accounts); In re Heims, 65 B.R. 112 (Bankr. N.D. Iowa 1986) (interest in Commodity Credit Corporation conservation program covered by security interest in contract rights and accounts).

In Lisbon Bank & Trust Co. v. Commodity Credit Corp., 679 F.Supp. 903 (N.D. Iowa 1987), the court found that the bank's security interest in contract rights covered payments under the Dairy Termination Program. This term sufficiently described the collateral for Iowa Code 554.9110. Citing several cases, the court stated that payments under government farm programs are commonly described as contract rights or general intangibles. Id. at 906. Cf. In re Waters, 90 B.R. 946 (Bankr. N.D. Iowa 1988) (CRP program payments were "rents," covered by security agreement listing all "government subsidy payments"). The phrase "contract rights" achieves the purpose of the financing statement, to allow identification of the collateral. Lisbon Bank, 679 F.Supp. at 906-07.

> [T]he phrase "contract rights" allows identification of contract payments pursuant to government farm programs. This is especially true, given the importance and awareness of the role of federal farm programs in financing farm operations.

Id., citing In re Sunberg, 729 F.2d at 562.

The Rolfe State Bank also claims that its contract rights derive from the original contract between the ASCS and the Smiths enrolling them in the farm program. Thus, although the Smiths signed up for the disaster program post-petition, the bank argues its interest in the payments arose pre-petition; the opportunity to qualify for the disaster payments was one of the rights under the base program. There is some authority to support this theory.

In In re Liebe, 41 B.R. 965 (Bankr. N.D. Iowa 1984), citing Sunberg, 35 B.R. at 784, the court found that PIK entitlements may be considered proceeds of the PIK contract for purposes of Bankruptcy Code 552. A pre-petition PIK contract would preserve the bank's security interest in PIK entitlements received post-petition. Liebe, 41 B.R. at 968; Thorp Credit, Inc. v. Fowler (In re Fowler), 41 B.R. 962 (Bankr. N.D. Iowa

1984). And see In re Matthieson, 63 B.R. 56 (D. Minn. 1986) in which the court found the debtors' rights under a deficiency program arose pre-petition when the debtors contracted with ASCS to enroll in the program. The court rejected the trustee's argument that the debtors' rights arose post-petition after the debtors had performed soil conservation requirements and the ASCS determined there was a deficiency. The program payments were subject to setoff.

The bank, in litigating its security interest in the Smiths' disaster payments, would have to show that the nature of the Smiths' base ASCS contract is analogous to the programs in the cases cited above to give it rights in the disaster payments. While the outcome of such litigation is not certain, case law supports the bank's position.

It is unnecessary for the court to decide the precise extent and nature of the bank's security interest in the disaster payments. The court need only decide if the trustee's compromise s reasonable, considering the bank's potential security interest. The foregoing cases support the bank's theory that the Smiths' entitlement to the disaster payments could be contract rights arising from the ASCS contract. The court finds that the trustee's decision to compromise the matter as proposed rather than litigate the issues is reasonable.

ORDER

IT IS ORDERED that the trustee's Motion for compromise or Settlement of Controversy is granted, and the compromise is approved.

SO ORDERED ON THIS 1ST DAY OF MARCH, 1993.

William L. Edmonds
Chief Bankruptcy Judge