IN THE UNITED STATES BANKRUPTCY COURT FOR THE
SOUTHERN DISTRICT OF MISSISSIPPI
JACKSON DIVISION

IN RE:

BOBBY G. JONES — CASE NO. 8301732JC

BOBBY G. JONES — PLAINTIFF

vs. — ADVERSARY NO. 840065JC

UNITED STATES OF AMERICA (FARMERS HOME ADMINISTRATION) — DEFENDANT

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Edward Ellington, Bankruptcy Judge

OPINION AND ORDER ON "MOTION TO DISMISS OR IN THE ALTERNATIVE MOTION FOR SUMMARY JUDGMENT" FILED BY THE UNITED STATES OF AMERICA (FARMERS HOME ADMINISTRATION)

STATEMENT OF THE CASE

An Order for Relief under 11 U.S.C. Chapter 11 was entered on a petition filed by Bobby G. Jones on October 14, 1983. The debtor filed the petition in an effort to reorganize his farming operations.

On March 26, 1984, this adversary proceeding was commenced by the Debtor filing a complaint against the United States of America, acting by and through the Farmers Home Administration, United States Department of Agriculture (hereinafter FmHA). The Complaint consists of three counts.

In Count I the Debtor seeks to have the FmHA return to the estate $36,000.00 which the FmHA had received from Payment-in-Kind (PIK) proceeds.

In Count II the Debtor requests a determination as to the value of the FmHa's collateral and a determination as to the amount of the FmHA's allowed secured claim pursuant to Section 504 of the Bankruptcy Code.

In Count III the Debtor sets forth a scenario of facts contending that FmHA refused to allow him to convert his farming operation from an unprofitable farming program to a profitable farming operation thereby causing him to suffer severe economic setbacks and eventually culminating in the instant bankruptcy. The Debtor seeks judgment against the FmHA in the amount of the losses sustained by him as a result of these actions of the FmHA.

The FmHA answered. It also filed a "Motion to Dismiss or in the Alternative Motion for Summary Judgment", together with supporting affidavits and

exhibits. It also filed a Memorandum Brief in support of its motion. The Debtor filed a Response and a Memorandum Brief. The FmHA finally filed a Rebuttal Memorandum Brief.

DISCUSSION

From April, 1977 to January, 1981, the Debtor received ten (10) loans from the FmHA. Each loan was evidenced by a separate promissory note executed and delivered by the Debtor. To secure the payment of these promissory notes and previous promissory notes, the Debtor executed and delivered nine (9) separate real estate deeds of trust between November, 1964 and March, 1981. These deeds of trust encumbered property of the Debtor in Simpson County, Mississippi, and were properly recorded in the land records of that county.

In addition to the foregoing real estate deeds of trust, and for the purpose of further securing the payment of the aforesaid promissory notes, the Debtor executed and delivered seven (7) security agreements encumbering his crops, equipment and livestock.

The State of Mississippi has adopted its version of the Uniform Commercial Code. The security interest in favor of the FmHA, and evidenced by the aforementioned security agreements, was perfected by the filing of UCC-1 financing statements with the

Chancery Clerk of Simpson County on May 28, 1977, May 23, 1978, March 3, 1979, and March 12, 1981.

In October, 1981, the Debtor planted a wheat crop and in June, 1982 he harvested 10,934 bushels of wheat. That same month he obtained a price support loan from the Commodity Credit Corporation and pledged the wheat as collateral. The proceeds of the loan went to the FmHA. The Debtor did not repay the CCC loan and the wheat which was stored on his farm was forfeited to the CCC.

On February 25, 1983, the Debtor made three separate applications to participate in the 1983 Payment-in-Kind (PIK) Diversion Program with the Commodity Credit Corporation. These applications were approved by the CCC on March 18, 1983.

The exact nature of the PIK program will be considered at a later point. However, as a result of the Debtor's participation in the 1983 PIK program the Debtor received PIK entitlements for a total of 11,220 bushels of wheat. The exact mechanics of the transactions are not completely clear from the affidavits and documents, but apparently in August, 1983, the Commodity Credit Corporation and/or the Debtor sold the 11,220 bushels of wheat. According to the affidavit of the county supervisor for the FmHA and footnote 1 of the Memorandum Brief of the FmHA the sale proceeds totaled $35,364.75. The FmHA received the net amount

of $30,585.40 and the balance of $4,779.35 was paid to C. D. Mullins, who was a landlord of the Debtor. It is not clear if the money was first paid to the FmHA and it then paid over to the landlord or what the exact circumstances were.

The initial question before this Court as presented by the brief of the FmHA is whether the proceeds from the sale of the 11,220 bushels of wheat to which the Debtor became entitled under the PIK program are proceeds which were secured by the aforesaid FmHA security agreements and financing statements.

Each of the security agreements signed by the Debtor was a preprinted FmHA form. The pertinent language identifying the nature of the security was identical in all of the agreements and the following excerpt from the agreement dated March 12, 1981, is typical, to-wit:

Item 1. All crops, annual and perennial, and other plant products now planted, growing or grown, or which are hereafter planted or otherwise become growing crops or other plant products (a) within the one-year period or any longer period of years permissible under State law, or (b) at any time hereafter if no fixed maximum period is prescribed by State law, on the following described real estate:

Farm(s) or Other Real Estate Owner	*Approximate No. of Acres*	*County and State*	*Approximate Distance and Direction from a Named Town or other Description*
Bobby G. Jones	957	Simpson-Ms	12 mi S of Magee, Ms.
James L. Terry	140	Simpson-Ms	Sec. 25 T10N. R19W
Rosetta Bethea	14	Simpson-Ms	Sec 34, T10N R19W
Willie Smith	46	Simpson-Ms	Sec 34, T11N, R2E
A. V. Smith	142	Simpson-Ms	Sec 3, T10N, R21W
Troy Lee Dampeer	40	Simpson-Ms	Sec. 1, T10N, R21W
Mrs. Curtis Thompson	160	Simpson-Ms	Sec. 27, T10N, R19W
Chas. Waltman	86	Simpson-Ms	Sec 34, T10N, R18W
John Williams Estate	20	Simpson-Ms	Sec 34, T10N R19W
Hubert Berry	30	Simpson-Ms	8 mi S of Magee, Ms.
C. S. Hemby	30	Simpson-Ms	same area
Mrs. L. G. Herrington	30	Simpson-Ms	same area
Dwight Smith	40	Simpson-Ms	6 mi S of Mendenhall, Ms.

Pursuant to Section 75-9-306, Mississippi Code of 1972, and the UCC-1 financing statements which had been filed, the FmHA was entitled to any proceeds from the sale of its collateral.

The question narrows to whether the wheat which the Debtor received from its participation in the PIK program constituted collateral pursuant to the aforesaid language contained in the preprinted security agreements.

The general question of whether payments made pursuant to various federal farm programs constitute proceeds of collateral as defined and identified in differing security agreements has been considered by at least three circuit courts of appeals and a number of district and bankruptcy courts. The results have not been consistent. Matter of Schmaling, 783 F.2d 680 (7th Cir. 1986); Pombo v. Ulrich (Matter of Munger), 495 F.2d 511 (9th Cir. 1974); In re Sunberg, 729 F.2d 561 (8th Cir. 1984); U. S. v. Carolina Eastern Chemical Co., 638 F.Supp. 521 (D.S.C. 1986); In re Lions Farms, Inc., 54 B.R. 241 (Bkrtcy.D.Kan. 1985); In re Kruse, 35 B.R. 958 (Bkrtcy.D.Kan. 1983); In re Frasch, 53 B.R. 89 (Bkrtcy.D.S.D. 1985); In re Mattick, 45 B.R. 615 (Bkrtcy.D.Minn. 1985); Matter of Binning, 45 B.R. 9 (Bkrtcy.S.D.Ohio 1984); In re Schmidt, 38 B.R. 380 (Bkrtcy.D.N.D. 1984); Matter of Azalea Farms, Inc., 68 B.R. 32 (Bkrtcy.M.D.Fla. 1986); Barash v. Peoples

National Bank of Kewanee (In re Kruger), 78 B.R. 538 (Bkrtcy.C.D.Ill. 1987); Settles v. U.S. (In re Settles) 69 B.R. 634 (Bkrtcy.C.D.Ill. 1987); Apple v.Miami Valley Production Credit Assoc., 804 F.2d 917 (6th Cir. 1986); In re Judkins, 41 B.R. 369 (Bkrtcy.M.D.Tenn. 1984); In re Cupp, 38 B.R. 953 (Bkrtcy.N.D.Ohio 1984); In re Lee, 35 B.R. 663 (Bkrtcy.N.D.Ohio 1983); Osteroos v. Norwest Bank Minot, N.A., 604 F.Supp. 848 (D.N.D. 1984); In re Sunberg, 35 B.R. 777 (Bkrtcy.S.D.Iowa 1983), aff'd 729 F.2d 561 (8th Cir. 1984); In re Schmidt, 38 B.R. 380 (Bkrtcy.D.N.D. 1984); U.S.A. v. Hollie (Matter of Hollie), 42 B.R. 111 (Bkrtcy.M.D.Ga. 1984); In re Nivens, 22 B.R. 287 (Bkrtcy.N.D.Tex. 1982); In re Hardage, 69 B.R. 681 (Bkrtcy.N.D.Tex. 1987); In re Kingsby, 73 B.R. 767 (Bkrtcy.D.N.D. 1987); In re Preisser, 33 B.R. 65 (Bkrtcy.D.Colo. 1983); In re Patsantaras Land and Livestock Co., 60 B.R. 24 (Bkrtcy.D.Colo. 1986).

In considering the issue, this Court is of the opinion that it is imperative to keep in mind the particular type farm program involved and that the answer will reasonably vary depending upon the program and the exact wording of the security agreement. This point is well stated by Judge Altenberger in the case of Barash vs. Peoples National Bank of Kewanee (In re

Kruger), 78 B.R. 538 (Bkrtcy.C.D.Ill. 1987) where he states:

> [I]t is this Court's view it is necessary to examine each particular government program to determine the basis or nature of the subsidy payment and then to determine if payments of that nature fall within the definition of the term "proceeds".
>
> All government farm subsidy payments are not of a similar nature. There are a variety of government subsidy payments available to farmers, some of which have become the subject of litigation on the issue of whether they are "proceeds".
>
> 78 B.R. at 539.

Judge Altenberger then goes on to list and describe some of the government programs, which is a helpful tool for anyone trying to study and reconcile the various cases in this area. He describes the program for the abandonment of sugar beets; for the termination of dairy herds; the Payment-In-Kind (PIK) Program, such as the one in the case at bar; the Agricultural Conservation Program, which involves soil conservation; the Price Support Program, which generates "sealing profits"; and the Federal Feed, Grain and Wheat Program, which generates what is commonly called the "deficiency payment." 78 B.R. at 539-40.

As has been previously noted, the Debtor planted wheat in October, 1981, harvested it in June, 1982, and immediately obtained a loan from the CCC and

pledged the wheat as collateral. Thirty-Four Thousand Four Hundred Twenty-Three and 50/100 Dollars ($34,423.50) was disbursed on the loan at that time and it was given to the FmHA to apply on the Debtor's account. As a part of the loan, in May, 1983 the CCC issued a final check in the amount of $3,825.50. There is some dispute as to whether the Debtor or the FmHA got proceeds of this final check. This particular loan program is the Price Support Program which is described in the Kruger case by Judge Altenberger as follows:

> Under this program the Commodity Credit Corporation (CCC) loans the farmer money at a predetermined price per bushel rate for the crop. If the open market price of the crop rises above the loan rate, the farmer can sell the crop on the open market and repay the loan. Any excess proceeds are available for the farmer's use. If the open market price of the crop drops below the loan rate, the farmer can dispose of the crop through the CCC at the subsidized rate, thereby realizing a profit the farmer would not be able to otherwise obtain. This profit is what is commonly known as the "sealing profit".
>
> 78 B.R. at 540.

The program which the Debtor applied for on February 25, 1983, and is the program which is being directly considered in this case is the Payment-In-Kind (PIK) Diversion Program. It is described in the case of Matter of Binning, 45 B.R. 9 (Bkrtcy.S.D.Ohio 1984) as follows:

> While the statutes and regulations governing these programs are at best arcane, the concept underlying them is a simple one. In exchange for not planting a particular crop and adhering to a conservation program as to the idle land, a participant receives payments in the form of commodities or cash. The amount of PIK payments is calculated by multiplying a set percentage of the proven crop yield times the number of acres set aside. Similarly, the land diversion payments are calculated by multiplying the set percentage of the proven crop yield times the number of acres diverted times the diversion price per bushel. **See,** 7 U.S.C. §§ 1444(e); 1445b-1(e); 7 C.F.R. Part. 713; 7 C.F.R. 770.1-770-6 (48 Fed.Reg. 1694-97 (Jan. 14, 1983), **as amended** 48 Fed.Reg. 9232-35 (March 4, 1983)).
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> 45 B.R. at 11.

This Court has carefully considered the Memorandum Brief of the FmHA and the cases cited therein in support of its argument that it was entitled to the wheat received by the Debtor under the PIK Program. For instance, in the case of In re Munger, 495 F.2d 511 (9th Cir. 1974), the farmer had planted a sugar beet crop, he then abandoned the crop and received payments under the Sugar Beet Abandonment Program. The Court held that these payments were proceeds of the crop.

In the case of In re Sunberg, 35 B.R. 777 (Bkrtcy.S.D. Ohio 1983) the PCA had a perfected security agreement in crops, growing crops, farm products,

contract rights, accounts and general intangibles existing or thereafter acquired. The farmer entered into the PIK Program and the Court held that the debtor's contractual right to a Payment-In-Kind was a general intangible under UCC Section 9-16, and that pursuant to the security agreement PCA was entitled to the PIK payment. Other cases cited by the FmHA relate to various and sundry government programs.

After consideration of the numerous circuit, district and bankruptcy court cases previously cited in this opinion; the exact language of the security agreements involved; and the particular farm program now before the court, this court is of the opinion that the logic and reasoning contained in the opinion in the Seventh Circuit case of Matter of Schmaling, 783 F.2d 680 (7th Cir. 1986) and the district court case which followed it, U. S. v. Carolina Eastern Chemical Co., 638 F.Supp. 521 (D.S.C. 1986) to be especially pursuasive and controlling in the present case.

The case of Barash vs.Peoples National Bank of Kewanee (In re Kruger), 78 B.R. 538 (Bkrptcy.C.D. Ill. 1987), actually dealt with deficiency payments but it contains a good analysis of Matter of Schmaling, supra, and many of the farm program "proceeds" cases cited by the FmHA, as do the Schmaling and Carolina Eastern cases.

In the Schmaling case, on May 5, 1982, the debtors gave to a Bank a security agreement covering the following collateral:

> All of the farm machinery and equipment, livestock and the young and products thereof, corn and all other crops grown or growing, and the feed, seed, fertilizer, and other supplies used in connection with the foregoing which are now owned or existing, and which are now located on the [Schmalings'] real estate..., together with all property of a similar nature or kind to that therein described which may be hereafter acquired . . . .

783 F.2d at 681.

In 1983 the debtors entered into a contract to participate in the PIK Program in which the government transferred to them bushels of corn. The debtors assigned their PIK rights to three other parties. In March, 1984, the debtors filed for bankruptcy and a question arose as to whether the Bank or the other parties were entitled to the proceeds from the PIK corn.

The Bankruptcy Court ruled for the Bank and concluded that, "although the agreement did not contemplate the not-as-yet-commenced Payment-in-Kind program and its proceeds specifically, its coverage was intended to be broad so as [sic] cover all of the debtor's farm-related assets." 783 F.2d at 682.

District Court affirmed and on appeal the Circuit Court reversed the case. In its opinion, the Circuit Court stated:

> Because the Bankruptcy court found the Schmalings' intent to grant the Bank a security interest in all farm-related assets to be clear, it eschewed engaging in a "hypothetical bout over the meaning of the word 'crops.'" (citation omitted). However, a security interest granted by a debtor to a creditor is limited strictly to the property or collateral described in the security agreement. (citations omitted). Here, the security agreement does not refer to all farm-related assets. Rather, it grants the bank a security interest in certain specific assets pertaining to the debtors' farm, including "corn and all other crops grown or growing." Crops are "products of the earth which are the result of annual labor and cultivation...by the person in possession of realty." (citations omitted).
>
> For something to be "proceeds" of crops, therefore, it must be received upon their "sale, exchange, collection or other disposition." U.C.C. §9-306(2). (citations omitted). But in the instant case there was never a crop of which to dispose. No corn was grown on the Schmalings' real estate. One condition for participating in the PIK program was that individuals **not** plant a crop.
>
> As a consequence, most courts have concluded that inkind payments do not constitute proceeds of crops. As the court held in **In re Mattick** 45 B.R. 615, 617 (Bankr.D.Minn. 1985), "Under the PIK programs involved in this case, the Debtors

> were paid for agreeing to forego planting any crop. They were not paid a subsidy. The right to the PIK entitlement was a general intangible, not proceeds of an existing, failed crop--or proceeds of anything. . . .
>
> 783 F.2d at 682, 683.

The Circuit Court then went on to analyze some of the leading cases in this field of the law. The opinion then continued:

> Some cases have concluded that because the PIK payments substitute for crops that would have been grown but for the participation in the program, PIK receipts are proceeds. **See In re Judkins,** 41 B.R. 369 (Bankr.D.Tenn. 1984); **In re Lee,** 35 B.R. 663 (Bankr.N.D.Ohio 1983). This argument has a certain appeal from an economic perspective since the government based its PIK calculations on the farmer's past and anticipated yields and intended the program to reduce production of certain crops. **See** 48 Fed.Reg. 9,233 (1983). This appeal is perhaps even greater where the farmer is paid in the commodity he would have planted. But the fact that the farmer ended up with bushels of corn to distribute cannot obscure the fact that PIK corn is not a "crop" from that farmer's land. Nor should the federal government's intent in managing its agricultural programs or the broad economics of the transaction override the plain language of a security agreement which extends only to crops. The rationale of the transaction cannot cure clear deficiencies in the description of the collateral.
>
> . . .

> Moreover, banks can easily avoid such potential losses of collateral by careful drafting, **see In re J. Catton Farms, Inc.**, 779 F.2d 1242, 1245 (7th Cir. 1985), and we see no good reason to apply unjustifiably loose constructions to documents of this kind. Even if this particular PIK program was new, land diversion programs and federal subsidies of this sort to farmers have been commonplace for years. ... The bank could presumably have acquired an interest in PIK revenues either by referring to government entitlements directly or by including a reference to general intangibles or to contract rights. **See In re Sunberg**, 35 B.R. 777. Since the Bank did none of these things, the district court was incorrect in granting it the right to the Schmaling's PIK payments.
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> 783 F.2d at 683, 684.

The case of U. S. vs. Carolina Eastern Chemical Co., supra, appears to be particularly applicable in the case at bar. In that case the farmer had borrowed from the FmHA and executed several security agreements and real estate mortgages to secure the indebtednesses. The last security agreement was dated August 30, 1982. The pertinent language in those agreements is contained in footnote 1. of the opinion and it is identical to the language contained in the preprinted FmHA security agreement forms which are involved in the case at bar. 638 F.Supp. at 522.

On September 1, 1982, a creditor, Carolina Eastern Chemical Co., Inc., obtained a judgment against the farmer for $77,118.45.

Similar to the Debtor in this case, that farmer entered into a contract to participate in the 1983 PIK program and thereafter the government issued him a PIK Entitlement Certificate representing a certain amount of cotton. A dispute then arose between the FmHA and the judgment creditor as to who was entitled to the proceeds. The farmer endorsed his interest in the check over to the creditor. The matter then came to be considered by the district court on a declaratory judgment action. The FmHA contended that the funds were "proceeds" of the interest in crops given in the security agreements. The creditor denied that any crop liens arising from the security agreements extended to proceeds of the federal PIK program.

In its opinion the district court reviewed the opinions of the three circuit courts and other lower courts and concluded that the language in the FmHA security agreements was not broad enough to encompass the commodities which were given to the farmer under the PIK program. The district court said:

> After a comprehensive examination of the cited authorities, this court finds the Seventh Circuit decision in **In the Matter of Schmaling** to be especially persuasive, and controlling in the present case. The court concludes that nowhere do the security agreements at issue here, **see** note 1, **infra,** furnish an identification of the collateral that could be construed broadly enough to reach the

PIK payments. Additionally, not a shred of evidence was ever adduced, and the government does not even maintain, that the government and Mr. McCutchen ever envisioned bringing PIK payments within the ambit of these security agreements.

The simple fact is that Mr. McCutchen never planted any crops to which the government's interest in "crop proceeds" could attach. To ignore this fact, and to hold as the government urges (i.e., that PIK payments are proceeds of McCutchen's crops) not only does violence to the plain language of the security agreements and the plain meaning of the phrase "proceeds of crops," but invites the court to engage in a type of legal alchemy the court is disinclined to perform. This court is unwilling to rewrite the instant security agreements based on its divination of the parties' intent or to extend coverage of a security agreement beyond the four corners of the documents. **In the Matter of Binning,** 45 B.R. 9, 13 (Bankr.S.D. Ohio 1984).

Land diversion programs administered by the government have existed for almost fifty years. **Schmaling** 783 F.2d at 684. As an agency of the government in farm loan programs the FmHA can hardly claim to be ignorant of such programs. As drafter of the subject security agreements, the FmHA will have the ambiguities in the documents construed against it. Should the government wish to bring PIK payments within security agreements executed in the future, it can easily alter the result obtained here by more careful drafting and explicit provisions.

638 F.Supp. at 525-26.

In the case of Barash vs. Peoples National Bank of Kewanee (In Re Kruger), supra, that court has a very precise summary of this court's understanding of In re Schmaling. In that case Judge Altenberger said:

> This Court's reading of **In re Schmaling** is that for a government farm subsidy payment to be considered "proceeds", three conditions must be present: First, a crop must be planted; second, there is a disposition of the crop; and third, the entitlement which the secured creditor is claiming must have been received in connection with that disposition.
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> 78 B.R. at 541.

Applying the aforesaid principles to the facts in the case at bar, this court is of the opinion that the Debtor's initial participation with the Commodity Credit Corporation in its Price Support Program in June of 1982 would be covered by the FmHA security agreements. In that case the Debtor had raised a crop of wheat which was covered by the FmHA security agreements. He pledged this wheat as security for a loan from the Commodity Credit Corporation. That crop was clearly covered by the FmHA security agreements and the FmHA was entitled to all of the proceeds from the loan.

A contrary result is reached considering his second involvement with the Commodity Credit Corporation. In 1983 the Debtor did not plant a crop;

therefore, there was no disposition of a crop and thus the entitlements which the FmHA is claiming were not received in connection with the disposition of a crop. The wheat received by the Debtor from the CCC in 1983 did not constitute collateral pursuant to the security agreements and the funds from the sale of the wheat did not constitute proceeds from the sale of collateral under the agreements.

The FmHA makes two other brief subsidiary arguments relating to Count I.

First, as a result of the Debtor's participation in the 1983 PIK program he earned entitlements to 11,200 bushels of wheat, which vested in the Debtor on June 15, 1983. FmHA asserts that since it had a security interest in the Debtor's crops that its security interest attached to this wheat on June 15, 1983, even if it did not have a lien on the Debtor's PIK entitlements.

This argument is not well taken for reasons previously stated. The wheat was a commodity given directly by the Commodity Credit Corporation to the Debtor for not farming and not producing a crop in 1983. The wheat came from the Commodity Credit Corporation and not from a crop produced by the Debtor on the land described in the FmHA security agreements.

To confuse the issue somewhat, actually 10,934 bushels of the wheat given to the Debtor by the

Commodity Credit Corporation had come from a crop produced by the Debtor in a previous year. At the time of production, the wheat had been covered under the FmHA security agreements as previously noted. However, title to this wheat had passed to the Commodity Credit Corporation as a result of the Debtor having participated in its Price Support Program and having failed to repay his loan. The FmHA had received the $34,423.50 from the proceeds of that loan on that crop. Thus, the fact that part of the wheat which the Commodity Credit Corporation gave to the Debtor in 1983 had originally been grown by the Debtor is of no real significance or consequence.

Second, the FmHA asserts that if it does not have a lien on the Debtor's PIK commodities that it should be entitled to a setoff against the proceeds in the amount of $9,661.82. This amount represents the total of a check in the amount of $5,836.32 which was returned to the FmHA for insufficient funds and the unaccounted proceeds from the CCC loan in the amount of $3,825.50.

The Debtor argues that there is a factual dispute between the parties as to the amount to which the government can offset, assuming that it is entitled to offset as a matter of law.

He further argues that there is a more fundamental problem with the government's contention on this

point, as a matter of law. The debtor contends that in order for a setoff to be allowed there must be "mutual debts" between the same parties. He argues that the FmHA and the Commodity Credit Corporation are separate parties, thus there is no mutuality and the government's claim of setoff must fail.

In considering this point, several parts of the Bankruptcy Code are pertinent. Section 553(a) specifically authorizes setoff and it provides in part:

> Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case, except to the extent that. . . .

Section 506(a) provides that the holder of a setoff is considered a secured creditor. It states in part:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. . . . (Emphasis added).

Section 101 is the definition section and it defines entity as follows:

> (14) "entity" includes person, estate, trust, governmental unit, and United States trustee;

The Commodity Credit Corporation is a federally created corporation (15 U.S.C. §714). Thus, there is some logic in the debtor's argument that since there are two separate governmental units involved there is no "mutuality" and therefore there can be no setoff. See In re Rinehart, 76 B.R. 746 (Bkrtcy. D.S.D. 1987).

However, the overwhelming weight of case law is to the contrary and supports the right of the FmHA to setoff.

In the Fifth Circuit case of United States v. Tafoya, 803 F.2d 140, 141 (5th Cir. 1986), the Court spoke to the general principal of the government's right to setoff:

> The right of setoff is "inherent in the United States Government," 26 Comp. Gen. 907, 908, and exists independent of any statutory grant of authority to the executive branch. **See Gratiot v. United States,** 40 U.S. (15 Pet.) 336, 10 L.Ed. 759 (1841); **McKnight v. United States,** 13 Ct.Cl. 292, 306 (1877), **aff'd,** 98 U.S. (8 Otto) 179, 25 L.Ed. 115 (1879). The scope of this common law right is broad. Historically, it has been exercised against anyone who has a "claim" against the government, including unpaid government contractors, **e.g. United States v.**

> **Munsey Trust Co.,** 332 U.S. 234, 67 S.Ct. 1599, 91 L.Ed. 2022 (1947), persons to whom the government owes retirement benefits, **e.g.** 16 Comp. Gen. 161; **id.** 1017; 17 **id.** 391; 19 **id.** 721; 21 **id.** 1000; **Boerner v. United States,** 30 F.Supp. 635; **aff'd,** 117 F.2d 387 (2d Cir. 1941), and employees to whom final salary payments or lump sum payments are due, **O'Leary v. United States,** 82 Ct.Cl. 305 (1936); 24 Comp.Gen. 552. (Footnote omitted).

The Supreme Court case of Cherry Cotton Mills, Inc. v. United States, 327 U.S. 536, 66 S.Ct. 729, 90 L.Ed. 835 (1946) is particularly relevant to the case at bar. In that case the Government owed Cherry Cotton Mills, Inc. a refund of taxes and Cherry Cotton Mills, Inc. owed the Reconstruction Finance Corporation, a government corporation, a balance on a note for borrowed money. In the Court of Claims the Government sought to setoff the claim held by the R.F.C. against the claim of Cherry Cotton Mills, Inc. to the tax refund. This was permitted by the Court of Claims.

On appeal to the Supreme Court, Cherry Cotton Mills, Inc. argued that the R.F.C. should be treated as a privately owned corporation and therefore a setoff and counterclaim should not be permitted. The Supreme Court rejected this argument and said:

> We have no doubt but that the set-off and counterclaim jurisdiction of the Court of Claims was intended to permit the Government to have

> adjudicated in one suit all controversies between it and those granted permission to sue it, whether the Government's interest had been entrusted to its agencies of one kind or another. Every reason that could have prompted Congress to authorize the Government to plead counterclaims for debts owed to any of its other agencies applies with equal force to debts owed to the R.F.C. Its Directors are appointed by the President and affirmed by the Senate; its activities are all aimed at accomplishing a public purpose; all of its money comes from the Government; its profits if any go to the Government; its losses the Government must bear. That the Congress chose to call it a corporation does not alter its characteristics so as to make it something other than what it actually is, an agency selected by Government to accomplish purely Governmental purposes. Inland Waterways Corp. v. Young, 309 US 517, 524, 84 L ed 901, 906, 60 S Ct 646. . . .

327 U.S. at 539.

The Commodity Credit Corporation is a similar government corporation (15 U.S.C. §§714-714(p)) and the right of the Government to setoff a tax refund due a bankrupt against an indebtedness which the bankrupt owed the Commodity Credit Corporation was clearly adjudicated in Luther v. United States, 225 F.2d 495 (10th Cir. 1954).

In more recent District and Bankruptcy Court cases, the courts have adjudicated or the parties have acknowledged the right of agencies of the United States government to make setoffs to collect debts owed to

other United States agencies. Waldron v. Farmers Home Administration, 75 B.R. 25 (Bankr. N.D.Tex. 1987); United States of America for Farmers Home Administration v. Parrish (In re Parrish), 75 B.R. 14 (Bankr.N.D.Tex. 1987); Buske v. McDonald v. United States, Intervenor (In re Buske), 75 B.R. 213 (Bkrtcy. N.D.Tex. 1987); In re Britton, No. 86-03019-M02 (Bkrtcy. E.D.N.C. Jan. 15, 1988); In re Thomas, No. 587-50118-7 (Bkrtcy. N.D.Tex. March 30, 1988).

This Court holds that as a matter of law the FmHA is entitled to setoff against amounts owed to the debtor by the CCC. However, there is a material dispute as to the amount of $9,661.82 which the FmHA seeks to setoff and summary judgment should not be granted for any specific amount without further hearing and development of the facts.

The Court observes that Section 362(a)(7) of the Bankruptcy Code provides that the automatic stay applies to setoffs and the Government has not filed any motion to lift the stay as to any setoff. The Court also observes that in the proof of claim filed by the FmHA it did not assert any right of setoff. In re Sound Emporium, Inc., 48 B.R. 1 (Bkrtcy. W.D.Tex. 1984); In re Thomas, supra.

In conclusion, as to Count I, the motion of the FmHA to dismiss or for summary judgment is not well

taken. The wheat which the debtor received from his participation in the 1983 PIK program with the CCC did not constitute collateral pursuant to the preprinted security agreements with the FmHA and the proceeds from the sale of the wheat were not secured by the aforesaid FmHA security agreements and financing statements.

As a matter of law, the FmHA is entitled to setoff, but there is a material factual dispute as to the $9,661.82 which it seeks to setoff and the FmHA has not filed a motion to lift the stay provided by 11 U.S.C. 362(a)(7).

COUNT II

The argument of the FmHA that Count II of the Debtor's complaint should be dismissed is well taken. In Count II of his complaint, the Debtor seeks a valuation hearing pursuant to 11 U.S.C. §506(a). Under Rule 3012 of the Bankruptcy Rules, this is a contested matter which should be done by motion rather than by an adversary proceeding under Bankruptcy Rule 7001.

COUNT III

In the final count of his complaint, the Debtor alleges that the FmHA tortuously interferred with control of his farming operation. This ultimately resulted in his bankruptcy and he seeks compensation.

The argument of the FmHA is also persuasive on this point. The Debtor has not complied with the procedural requirements of the Federal Tort Claims Act pursuant to 28 U.S.C. §2675(a) and Molinar vs. United States, 515 F.2d 246 (5th Cir. 1975).

IT IS, THEREFORE, ORDERED AND ADJUDGED that the motion of the FmHA to dismiss or for summary judgment is denied as to Count I of the Complaint of the Debtor.

IT IS FURTHER ORDERED AND ADJUDGED that Count II of the complaint wherein the Debtor seeks a valuation hearing should be, and it hereby is, dismissed without prejudice. The Debtor is permitted to seek a valuation hearing as may be provided by 11 U.S.C. §506 and the appropriate Bankruptcy Rules.

IT IS FURTHER ORDERED AND ADJUDGED that Count III of the complaint wherein the Debtor alleges that the FmHA tortuously interferred with the control of his farming operation should be, and it hereby is, dismissed without prejudice as to the rights of the Debtor to proceed as may be otherwise provided by law.

ORDERED AND ADJUDGED this the 11TH day of MAY, 1988.

Edward C. Clayton
UNITED STATES BANKRUPTCY JUDGE