

**IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF KANSAS**

<b>IN RE:</b>	)	
	)	
<b>GARY WILLIAM KLENKE,</b>	)	<b>Case No. 01-13051</b>
<b>SHEILA MARIE KLENKE,</b>	)	<b>Chapter 12</b>
	)	
<b>Debtor.</b>	)	
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	)	
<b>FIRST NATIONAL BANK</b>	)	
<b>OF SPEARVILLE, KANSAS,</b>	)	
	)	
<b>Plaintiff,</b>	)	
	)	
<b>v.</b>	)	<b>Adversary No. 02-5016</b>
	)	
<b>GARY WILLIAM KLENKE,</b>	)	
<b>SHEILA MARIE KLENKE,</b>	)	
	)	
<b>Defendants.</b>	)	
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**MEMORANDUM OPINION**

This adversary proceeding filed by First National Bank of Spearville, Kansas (“Bank”) seeks turnover of a post-petition Market Loss Assistance Program payment of \$25,074 received by defendants/debtors Klenke (“Klenke”). The Bank claims that by virtue of its security interest in debtors’ after-acquired farm program payments it is entitled to receive the payment received by Klenke postpetition on account of a government program which was not enacted until after their case was filed. Klenke claims that the payment is not property of the estate to which the Bank’s prepetition lien attached.

In addition to the parties’ Agreed Stipulations of fact filed September 12, 2003 (Dkt. 31), trial on the Bank’s turnover complaint was held on September 16, 2003. The Court also received post-trial

briefs from the Bank (Dkt. 33) and Klenke (Dkt. 34) and thereafter took the matter under advisement. The Court makes its findings of fact and conclusions of law pursuant to Fed. R. Bankr. P. 7052.

### Jurisdiction

The Court has jurisdiction over this proceeding pursuant to 28 U.S.C. § 1334. This adversary proceeding is a core proceeding under 28 U.S.C. § 157 (b)(2)(E) and (K).

### Findings of Fact

The facts established by the parties' stipulations, the exhibits received into evidence, and the trial testimony are as follows.

Debtors filed their Chapter 12 bankruptcy petition on June 26, 2001. On and before the date of filing, the Bank held a security interest in Klenke's inventory, equipment, crops, farm products, accounts, documents, general intangibles, and government payments and programs. The Bank's security interest in the foregoing collateral was properly perfected. The security agreement covering the Bank's security interest in government payments and programs provided:

All payments, accounts, general intangibles, or other benefits (including, but not limited to, *payments in kind, deficiency payments, letters of entitlement, warehouse receipts, storage payments, emergency assistance payments, diversion payments, and conservation reserve payments*) in which I now have and in the future may have any rights or interest and which arise under or as a result of any preexisting, current or future Federal or state governmental program (including, but not limited to, all programs administered by the Commodity Credit Corporation and the ASCS). [Emphasis added.]

The Bank's security interest also covered all proceeds of the described collateral.

In 1996, Klenke entered into a production flexibility contract (PFC) under the Agricultural Market Transition Act ("AMTA").<sup>1</sup> The AMTA provided farmers with guaranteed government

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<sup>1</sup> 7 U.S.C. § 7201 *et seq.* The provisions of the AMTA are carried out through the Commodity Credit Corporation (CCC) which is authorized to issue regulations for implementation of the AMTA. *See* 7 U.S.C. § 7281. The AMTA regulations are found at 7 C.F.R. ¶ 1412.101 *et*

payments based upon their crop, yield, and eligible contract acres. The MLAP was first enacted in 1998 to supplement the AMTA payments. A farmer who had entered into a PFC automatically qualified for a MLAP payment, without any further action.

Klenke received a MLAP payment of \$28,409 in 1999. The 1999 MLAP program expired in 2000. A new MLAP program was enacted in 2000 that expired prior to Klenke's bankruptcy filing. Klenke received a MLAP payment of \$29,210 in 2000. Both the 1999 and 2000 MLAP payments were applied to Klenke's loan balance with the Bank. In response to questioning by the chapter 12 trustee, Klenke testified that he reported these payments as income.

At trial, both sides presented evidence that Klenke was entitled to the MLAP payment without regard to whether a crop was planted. The Bank's loan officer Kevin Stein described the MLAP payment as additional or supplemental income when the market price was low.<sup>2</sup> The MLAP payment was determined by the farmer's base acres, not the number of planted acres. Mr. Stein testified that Klenke would have received a 2001 MLAP payment whether or not he had planted any wheat. Gary Klenke testified that his 2001 MLAP payment was based upon 1,792 base or contract acres. The MLAP paid on 85% of the base acres. Klenke testified that he would have received the 2001 MLAP payment regardless of whether a single crop was planted.

On August 13, 2001, after Klenke's bankruptcy, the 2001 MLAP program was enacted and Congress appropriated funds for the MLAP. Without any further action on the part of Klenke, the Government issued Klenke a \$25,074 check on August 16, 2001, representing the MLAP payment for 2001.

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*seq.*

<sup>2</sup> In response to questioning from the Court, Mr. Stein stated that the MLA program was not a disaster program nor a price support.

On January 14, 2002, the Bank filed its complaint for turnover of the 2001 MLAP payment, claiming it was subject to the Bank's prepetition security interest.

### Analysis

At the outset, some background pertaining to the AMTA and the MLAP is in order. The AMTA was enacted in 1996 as part of the Federal Agriculture Improvement and Reform Act of 1996.<sup>3</sup> Among the stated purposes of the AMTA is "to support farming certainty and flexibility while ensuring continued compliance with farm conservation and wetland protection requirement" through binding PFCs.<sup>4</sup> In general, it authorized the government to enter into seven (7) year PFCs (for the years 1996-2002) with eligible farm producers for certain crops.<sup>5</sup> Under the AMTA, any "contract commodity" could be planted by the farmer on the contract acres during 1996-2002 and the farmer was also permitted to graze or hay the contract acres.<sup>6</sup> But the eligible cropland could not be used for a nonagricultural commercial or industrial use. If no crop was planted, the farmer was required to comply with conservation requirements to prevent weeds and erosion.<sup>7</sup> Congress appropriated a set amount of funds each year for contract payments under the PFCs and allocated the amount among the eligible crops.<sup>8</sup> In sum, the AMTA provided a predetermined level of income support, but unlike most other agricultural programs, the annual PFC payments were not tied to market prices, production

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<sup>3</sup> See 7 C.F.R. ¶ 1412.101.

<sup>4</sup> 7 U.S.C. § 7201(b).

<sup>5</sup> See 7 U.S.C. §§ 7211- 7212; 7 C.F.R. ¶ 1412.201. The PFCs pertain to eligible cropland and certain crops or "contract commodities," including wheat, corn, and grain sorghum. See 7 U.S.C. § 7202(5); 7 C.F.R. ¶ 1412.103.

<sup>6</sup> 7 U.S.C. § 7211 and § 7218; 7 C.F.R. ¶ 1412.206.

<sup>7</sup> See 7 C.F.R. ¶ 1412.401.

<sup>8</sup> 7 U.S.C. § 7213.

levels, crop disasters, or acreage reduction.

The MLAP was first enacted in 1998.<sup>9</sup> It expired each year and required Congress to pass legislation and appropriate funds each year.<sup>10</sup> It was designed to supplement the PFC payments that a farmer receives under the AMTA.<sup>11</sup> Like the AMTA, annual MLAP payments are not determined by or tied to actual production levels, crops planted, or crops lost. Instead, Congress appropriated a predetermined amount for market loss assistance payments each year<sup>12</sup> and the appropriation was divided up among participating farmers based on a percentage multiple of their contract acreage.

The MLAP is related to the AMTA in that eligibility is dependent upon the producer receiving a PFC payment under the AMTA and the amount of the MLAP payment is proportional to the PFC payment. A farm producer is automatically eligible for a MLAP payment if he qualifies for a PFC payment under the AMTA. The 2001 version of the MLAP provided:

#### SECTION 1. MARKET LOSS ASSISTANCE.

(a) ASSISTANCE AUTHORIZED.--The Secretary of Agriculture (referred to in this Act as the "Secretary") shall, to the maximum extent practicable, use \$4,622,240,000 of funds of the Commodity Credit Corporation to make a market loss assistance payment to owners and producers on a farm that are eligible for a

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<sup>9</sup> Emergency and Market Loss Assistance, Pub. L. No. 105-277, 112 Stat. 2681 (October 21, 1998), *codified* at 7 U.S.C. § 1421 note, Subtitle B, Sec. 1111 (1999). Congress appropriated \$3,057,000,000 for market loss assistance payments for fiscal year 1998.

<sup>10</sup> *See* Pub. L. No. 106-78, 113 Stat. 1135 (October 22, 1999), *codified* at 7 U.S.C. § 1421 note; Pub. L. No. 106-224, 114 Stat. 358 (June 20, 2000), *codified* at 7 U.S.C. § 1421 note, Sec. 201 (2003 pocket part); Pub. L. No. 107-25, 115 Stat. 201 (August 13, 2001); Pub. L. No. 107-171, 116 Stat. 134 (May 13, 2002)

<sup>11</sup> The 2001 enactment described the MLAP as “[a]n Act to respond to the continuing economic crisis adversely affecting American agricultural producers.” *See* Pub. L. No. 107-25, 115 Stat. 201 (August 13, 2001).

<sup>12</sup> For fiscal year 2001, Congress appropriated \$4,622,240,000 for MLAP payments. *See* Sec. 1(a), Pub. L. No. 107-25, 115 Stat. 201 (August 13, 2001)

final payment for fiscal year 2001 under a production flexibility contract for the farm under the Agriculture Market Transition Act (7 U.S.C. 7201 et seq.).

(b) AMOUNT.--The amount of assistance made available to owners and producers on a farm under this section shall be proportionate to the amount of the total contract payments received by the owners and producers for fiscal year 2001 under a production flexibility contract for the farm under the Agricultural Market Transition Act.<sup>13</sup>

In short, the MLAP is an additional income support payment made to farmers that is determined by the amount of the annual PFC payment, which in turn is based upon a farmer's eligible contract acres, and not planted acres.

The MLAP funds claimed by the Bank were paid August 16, 2001 pursuant to the enactment of the MLAP and appropriation of funds by Congress on August 13, 2001. Both of these events occurred after Klenke file bankruptcy on June 26, 2001. Klenke became entitled to the MLAP payment because of his eligibility for PFC payments, not because of any relationship to prepetition crops. Indeed, it is undisputed from the evidence before the Court that Klenke would have qualified for the MLAP payment, even if there were no crops in the ground.

Driven by this set of facts, the Court must determine whether Klenke had an interest in the 2001 MLAP payment at the time of the bankruptcy filing to which the Bank's security interest in government program payments could attach. This requires considering (1) whether the 2001 MLAP payment is property of Klenke's bankruptcy estate; (2) whether the Bank had a prepetition interest in the payment or expectation of it; and (3) whether the Bank's interest in the payment qualifies for the proceeds exception of 11 U.S.C. § 552(b)(1). As discussed below, the Court concludes that the 2001 MLAP payment is property of the chapter 12 estate, but that the Bank had no prepetition security interest in it because the 2001 MLAP program was merely an expectation when the case was filed. The Court

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<sup>13</sup> Pub. L. No. 107-25, 115 Stat. 201 (August 13, 2001).

further concludes that the 2001 MLAP payment does not constitute “proceeds” of a prepetition security interest.

The scope of the Chapter 12 estate is defined by 11 U.S.C. § 1207. Section 1207(a)(1) specifically includes in the estate’s embrace “all property of the kind specified in [§541] that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7 . . . .”<sup>14</sup> Thus, the 2001 MLAP payment is included in the debtors’ chapter 12 estate.

Whether the Bank’s prepetition security interest in after-acquired property attaches to the payment must be determined by application of 11 U.S.C. § 552. The effect of the Bank’s dragnet clause is limited by § 552 of the Bankruptcy Code, which 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)(1) Except as provided in sections 363, 506(c), 522, 544, 545, 547, and 548 of this title, if the debtor and an entity entered 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 . . . of such property, then such security interest extends to such proceeds . . . acquired by the estate after the commencement of the case to the extent provided by such security agreement . . . .<sup>15</sup>

Section § 552(a) cuts off security interests in after-acquired property and their proceeds as of the date of the filing. Thus, in order to avoid the effect of § 552(a) and fit within the proceeds exception of § 552(b)(1), the Bank must show that its security interest attached to some collateral prepetition of which the MLAP payment was a proceed.

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<sup>14</sup> 11 U.S.C. § 1207(a)(1) (West 2003).

<sup>15</sup> 11 U.S.C. § 552.

The Bank argues that even though the 2001 MLAP was not in existence or authorized prepetition, the 2001 payment was sufficiently “rooted” in prepetition farming activities because of Klenke’s expectation that a MLAP appropriation would be approved and because Klenke’s participation in prior years’ PFCs was a condition precedent to his receiving MLAP payments. The Court disagrees.

The only binding appellate authority on post-petition receipt of farming entitlements and their status is *Schneider v. Nazar (In re Schneider)*,<sup>16</sup> where the Tenth Circuit Court of Appeals held that proceeds from a government PIK (Payment-in-kind) contract were not property of the estate where the debtors’ eligibility to participate in the PIK program was not determined and enrollment in the program did not occur until after debtors had filed their chapter 7 bankruptcy petition. Unlike the instant case, the government PIK program was enacted before the debtor filed bankruptcy, but the debtor’s PIK contract was not fully executed until after the case was filed. On those facts, the Tenth Circuit denied the trustee turnover of the PIK benefit.

More helpful here is *Sliney v. Battley (In re Schmitz)*,<sup>17</sup> where the Ninth Circuit Court of Appeals analyzed whether certain fishing-quota rights ultimately enacted and acquired by the debtor post-petition were included in the debtor’s chapter 7 estate, stating:

Any number of legal, political or bureaucratic factors can affect whether mere proposals ever ripen into full-fledged regulations. Rule-making is like baseball: It ain’t over ‘til it’s over. On the date that Schmitz filed his petition, he might have had a hope, a wish and a prayer that the Secretary would eventually implement the plan then under consideration. However, the fact remains that as of the date of the petition, Schmitz’s 1988-1990 catch history had no value. At most, there existed the possibility that his prior catch record *might* be relevant *if* a fishing quota program were ever

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<sup>16</sup> 864 F.2d 683 (10th Cir. 1988).

<sup>17</sup> 270 F.3d 1254 (9th Cir. 2001), reversing the Bankruptcy Court, 224 B.R. 117 (Bankr. D. Alaska 1998), and Bankruptcy Appellate Panel, 246 B.R. 452 (9th Cir. BAP 1999).

adopted in a form favorable to him, *if* his application for such rights were granted, and *if* he could successfully defend against any competing challenge to his application. This sort of nebulous possibility is not property.<sup>18</sup>

Dealing with post-petition MLAP and crop loss disaster assistance payments (“CLDAP”), the Eighth Circuit Bankruptcy Appellate Panel (BAP) reached the same conclusion in *In re Vote*.<sup>19</sup> It stated:

As of the date the Debtor filed his bankruptcy petition, he may have had, at most, an expectation that Congress would enact legislation authorizing crop disaster or assistance payments to farmers affected by the weather conditions in 1999, but there was no assurance that Congress would authorize such payments or that the Debtor would qualify for them if they were authorized. It was equally likely that Congress would *not* pass such relief legislation. Such an expectancy (or “hope,” if you will) does not rise to the level of a “legal or equitable interest” in property such that it might be considered property of the estate under 11 U.S.C. § 541(a)(1).<sup>20</sup>

So too, here, Klenke’s expectation that 2001 MLAP legislation would be passed and funds appropriated was nothing more than a “nebulous possibility.” It does not “rise to the level of a legal or equitable interest in property” and therefore cannot be property to which the Bank’s security interest could have attached prepetition. Instead, it is after-acquired property for which the Bank’s security interest is cut off by operation of § 552(a).<sup>21</sup>

Nor does the 2001 MLAP payment constitute proceeds of a prepetition interest, leaving it outside the ambit of § 552(b)(1). “Proceeds” are defined in Revised Article 9 of the Kansas Uniform Commercial Code to mean “[w]hatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral” and “whatever is collected on, or distributed on account of, collateral.”<sup>22</sup>

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<sup>18</sup> *Id.* at 1257.

<sup>19</sup> 261 B.R. 439 (8th Cir. BAP 2001), *aff’d* 276 F.3d 1024 (8th Cir. 2002).

<sup>20</sup> *Id.* at 444.

<sup>21</sup> *See also, In re Stallings*, 290 B.R. 777, 780-82 (Bankr. D. Idaho 2003).

<sup>22</sup> *See* KAN. STAT. ANN. § 84-9-102(64)(A) and (B) (2002 Supp.).

The Bank urges that the MLAP payments are proceeds of prepetition interests but, in this case, the nature of the MLAP payment distinguishes it from the disaster payment cases upon which the Bank relies.

Unlike the CLDAP crop disaster payments at issue in *Lemos v. Rakozy (In re Lemos)*<sup>23</sup> and *In re Shore Limited, A Partnership*,<sup>24</sup> the 2001 MLAP payment was not attributable to any prepetition crop or other interest. It is not a disaster benefit. In *Lemos*, the debtor filed a chapter 12 bankruptcy and converted to chapter 7 in 1998. Thereafter, the CLDAP was enacted. In 1999, the debtor applied for disaster payments under the multi-year portion of the program, showing that he had received prepetition crop loss indemnity payments in 1994, 1995 and 1996. The debtor received a CLDAP payment in 1999. The trustee claimed the 1999 CLDAP payment was estate property subject to administration in debtor's bankruptcy case while the debtor claimed the government payment was not property of the estate because the CLDAP and implementing regulations were not enacted until after debtor filed bankruptcy. The bankruptcy court held that the CLDAP payment was property of the estate under § 541(a)(1) because it resulted from prepetition activities and events (*i.e.* qualifying crop losses occurred prepetition). The bankruptcy court held in the alternative that the CLDAP payments were supplemental to the indemnity payments for prepetition crop losses, and as such, were proceeds and property of the estate under § 541(a)(6). Thus, the trustee prevailed over the debtor. There was no issue in this case concerning the status of a secured lender.

In *Shore*, this Court expressly noted the purpose of the CLDAP was to “make disaster payments available to certain producers who have incurred losses in quantity or quality of their crops

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<sup>23</sup> 243 B.R. 96 (Bankr. D. Idaho 1999).

<sup>24</sup> Case No. 99-40689 (Bankr. D. Kan. June 4, 2001).

due to disasters.”<sup>25</sup> Simply stated, the CLDAP payments in *Lemos* and *Shore* were payments for the disposition (destruction) of prepetition failed crops while in the instant case, MLAP funds are not moneys received on account of and bear no relationship to any prepetition crop. The amount of Klenke’s MLAP entitlement was determined by his eligibility for a PFC contract payment. Klenke would have received the MLAP payment even had he planted no crop. Thus, the MLAP payment cannot be said to result from the sale, transfer, or other disposition of a crop and is therefore readily distinguishable from a disaster payment. It is not “proceeds” as this Court understands that term’s use either in § 552(b)(1) or the Uniform Commercial Code.<sup>26</sup>

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<sup>25</sup> Case No. 99-40689, slip op. at 2, *citing* 7 C.F.R. Part 1477.101(a).

<sup>26</sup> *Cf. In re SMS, Inc.* 15 B.R. 496, 499 (Bankr. D. Kan. 1981) (proceeds are whatever is substituted for the original collateral); *Nivens v. Holder (In re Nivens)*, 22 B.R. 287, 291 (Bankr. N.D. Tex. 1982) (disaster payments are merely the substitute for proceeds of the crop that would have been received had the disaster or low yields not occurred).

Conclusion

The 2001 MLAP payment received pursuant to a program enacted after Klenke's bankruptcy was filed and paid to Klenke post-petition is property of the Chapter 12 estate, but is after-acquired property in which the Bank's security interest is cut off by operation of 11 U.S.C. § 552(a). Because the 2001 MLAP payment was not received on account of any sale, transfer or disposition of a prepetition asset or entitlement, it is not proceeds of any prepetition collateral in which the Bank had a security interest and is therefore not saved by the § 552(b)(1) exception. Klenke is entitled to retain the 2001 MLAP payment and to a judgment DENYING the Bank's complaint for turnover of the 2001 MLAP payment in the amount of \$25,074. A Judgment on Decision will issue this day.

Dated this 3rd day of February, 2004.

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ROBERT E. NUGENT  
CHIEF BANKRUPTCY JUDGE  
UNITED STATES BANKRUPTCY COURT  
DISTRICT OF KANSAS

## CERTIFICATE OF SERVICE

The undersigned certifies that a copy of the **Memorandum Opinion** was deposited in the United States mail, postage prepaid on this 3rd day of February, 2004, to the following:

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