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GOVERNMENT PAYMENTS: WHEN DO THEY BECOME PROPERTY OF THE ESTATE?

ABSTRACT

Government payments received by a debtor postpetition are often tied to prepetition events, presenting the issue of whether a legal or equitable interest existed as of the commencement of the case under § 541 of the Bankruptcy Code. The Fifth, Eighth, Ninth, and Eleventh Circuits have held that a debtor has no legal or equitable interest in a government payment until the legislation authorizing the payment is signed into law. These decisions, however, failed to articulate a clear standard, as evidenced by recent case law.

The issue of when a government payment becomes property of the estate has been particularly contentious in the crop disaster payment context. A new program, the Supplemental Revenue Assistance Program (SURE), presents a novel fact pattern. In SURE, the Secretary of Agriculture must designate the county where a crop was lost as a disaster county before a farmer can qualify for payment. Therefore, when a bankruptcy petition is filed, payment may still be contingent upon an act within the agency's discretion.

This Comment will argue that a government payment becomes property of the estate when the payment is "absolutely owed," meaning the payment is no longer contingent in any way. First, the case law reveals no clear standard as to when a government payment becomes property of the estate under § 541. The right to setoff in § 553 has a clearer rule, a contrast that can help guide analysis. Second, recent cases regard the statutory authorization date as determinative, but this approach runs contrary to the Code and relevant case law, for §§ 541 and 553 require a more nuanced factual inquiry. Third, administrative law dictates that a government payment becomes an entitlement for purposes of due process when legal sources create enforceable standards that guide an agency's discretion. This standard should control when agency discretion is an issue.

INTRODUCTION

Once a debtor obtains a legal or equitable interest in a government payment, two sections of the Bankruptcy Code (Code) are at play. The first is § 541(a) of the Code, which governs when property becomes part of the bankruptcy estate.¹ The second is § 553, which preserves a creditor's right to offset an obligation to a debtor against the debtor's obligation to the creditor.² In deciding whether postpetition government payments were property of the estate, courts initially took an expansive view, concluding that debtors have a legal or equitable interest in a government payment as long as the loss or event to which the payment is tied to occurred prepetition. Courts reached this result even when legislation authorizing the payment was passed postpetition. In the past ten years, the Fifth, Eighth, Ninth, and Eleventh Circuits have narrowed this expansive interpretation of § 541, and have held that a debtor has no legal or equitable interest in a government payment until the legislation authorizing the payment is signed into law.³ These decisions, however, fail to articulate a clear standard.

Analysis of recent cases reveals that the lack of a clear standard has led courts to produce inconsistent holdings, often concluding that a debtor does not have a legal or equitable interest in a government payment until the statutory authorization date.⁴ This approach runs contrary to the Code, which requires a more nuanced factual inquiry.⁵ Under § 541(a) courts should analyze the government payment program and the facts of the case to determine if all the conditions necessary for the payment to be a legal or equitable interest occurred prepetition.⁶ Importing the language from the right to setoff set forth in § 553, the payment must be "owing" at the time of the petition in order for a creditor to possess the right to setoff.⁷ Using such language in the context of § 541(a) analysis is useful because it emphasizes the necessary factual inquiry courts must engage in under both provisions.

¹ 11 U.S.C. § 541(a) (2012).

² *Id.* § 553.

³ *See* *Bracewell v. Kelley (In re Bracewell)*, 454 F.3d 1234, 1239 (11th Cir. 2006); *Burgess v. Sikes (In re Burgess)*, 438 F.3d 493, 507 (5th Cir. 2006); *Drewes v. Vote (In re Vote)*, 276 F.3d 1024, 1026–27 (8th Cir. 2002); *Sliney v. Battley (In re Schmitz)*, 270 F.3d 1254, 1255 (9th Cir. 2001).

⁴ *See generally In re Farmer*, No. 10-09353, 2012 WL 4905480 (Bankr. E.D.N.C. Oct. 15, 2012).

⁵ *See generally* 11 U.S.C. §§ 541(a), 553.

⁶ *See id.* § 541(a).

⁷ *See generally id.* § 553.

If a court engages in the necessary factual inquiry, it may encounter unique factual wrinkles. One government payment program, the Supplemental Revenue Assistance Program (SURE), is an illustrative example. The SURE program provides assistance to farmers who have lost crops due to a natural disaster.⁸ Under SURE, the Secretary of Agriculture must designate the county where the crop was lost as a disaster county before the farmer can qualify for payment.⁹ Therefore, at the time a bankruptcy petition is filed, payment may still be contingent upon an act within the agency's discretion.¹⁰ The novel factual issue presented by this program is whether a government payment is property of the estate when a government agency has discretion over a qualification requirement at the time of the bankruptcy petition.

When the mechanics of a government payment program pose an issue of agency discretion, bankruptcy courts should look to administrative law. Administrative law dictates that a government payment becomes an entitlement for purposes of due process when legal sources create enforceable standards that guide an agency's discretion.¹¹ This standard should be adopted when determining whether a government payment is property of the estate. This Comment will argue that a government payment becomes property of the estate when it is "absolutely owed," meaning all contingencies for payment are satisfied, including when enforceable standards remove an agency's discretion.

I. BACKGROUND

To determine exactly when a government payment becomes "absolutely owing," a court must engage in a factual inquiry of the government payment program at issue, and apply the mechanics of the program to the facts of the case. The SURE program provides an illustrative example of how a court would conduct this analysis, including discussion of the relevant statutes and regulations. It also demonstrates how novel issues can arise when a court engages in a close factual analysis of a government payment program. In particular, SURE presents the problem of agency discretion over a condition

⁸ Farm Serv. Agency, *Fact Sheet, Supplemental Revenue Assistance Payments (SURE) Program*, U.S. DEP'T OF AGRIC., 1 (Jan. 2011), http://www.fsa.usda.gov/Internet/FSA_File/sure_2011.pdf.

⁹ *Id.* at 1–2.

¹⁰ See Motion to Lift Stay and For Offset, *In re Farmer*, No. 10-09353 (Bankr. E.D.N.C. Feb. 29, 2012); *Emergency Designation News Release*, U.S. DEP'T OF AGRIC. (Dec. 2010), https://www.fsa.usda.gov/FSA/newsReleases?area=newsroom&subject=landing&topic=edn&newstype=ednewsrel&type=detail&item=ed_20101201_rel_0128.html [hereinafter *News Release*] (declaring forty-two counties in North Carolina as Primary Natural Disaster Areas should provide aid for affected farmers).

¹¹ *See Board of Regents v. Roth*, 408 U.S. 564, 577–78 (1972).

necessary for payment. This issue arises when a Secretarial Disaster Designation has yet to be made at the time of the petition.

Historically, most crop disaster payment programs have been either permanently funded and immediately available through successive Farm Bills or authorized by Congress as patchwork relief after a natural disaster occurred.¹² SURE is a relatively new crop disaster payment program authorized by the 2008 Farm Bill.¹³ Eligibility is dependent upon the farmer holding the Farm Service Agency (“USDA”) crop insurance for the relevant crop year as well as a documented qualifying crop loss.¹⁴ A 10% qualifying loss is required if the farmer’s land is located in a Designated Secretarial Disaster County (designated by the Secretary of Agriculture), or a 50% qualifying loss if the land is located in a non-Designated Secretarial Disaster County.¹⁵

In the SURE program, an eligible producer can receive a payment equal to 60% of the difference between the targeted level of revenue and the actual total revenue received during the relevant crop year.¹⁶ To find the targeted level of revenue, USDA calculates the average market price of the crop over the course

¹² DENNIS A. SHIELDS & RALPH M. CHITE, CONG. RESEARCH SERV., RS21212, AGRICULTURAL DISASTER ASSISTANCE 1 (2010). The areas it covers include crop subsidies, international trade, rural development, food safety, and environmental conservation. The USDA disaster payment programs relating to crop loss that enjoy regular Farm Bill funding include NAP (Noninsured Crop Disaster Assistance Program), and Emergency Farm Loans. *Id.* at 2–3, 6–7.

¹³ *Id.* at 4. Funding is allocated for the 2008–2011 crop years. See generally Definition of *Crop Year*, INVESTOPEDIA, <http://www.investopedia.com/terms/c/croyear.asp#axzz2Lkq1mjZl> (last visited Mar. 6, 2013) (A crop year is defined as “[t]he time period from one year’s harvest to the next for an agricultural commodity. Crop year varies for each commodity . . . [and] has an influence on the price of a commodity, since the quality of the harvest may differ from year to year.”). In December of 2012, Congress extended the 2008 Farm Bill for nine months, effectively funding the SURE program for the 2012 crop year. See David Rogers, *Fiscal Cliff Deal Includes Farm Bill Extension*, POLITICO (last updated Jan. 12, 2013, 10:23 AM), <http://www.politico.com/story/2013/01/fiscal-cliff-deal-include-farm-bill-extension-85641.html>.

¹⁴ U.S. DEP’T OF AGRIC., *supra* note 8. A “qualifying crop production loss” is a term used in the various crop disaster assistance programs to indicate the loss at issue has an eligible producer, an eligible crop, and loss stemming from an eligible natural disaster. An eligible producer must be a landowner, tenant or sharecropper who shares in the risk of producing a crop. An eligible crop is a commercially produced crop, grown for food, livestock production or some other agricultural purpose. An eligible natural disaster includes damaging weather such as drought or floods, adverse natural occurrences or a condition relating to damaging weather such as excessive heat. *Supplemental Revenue Assistance Payments (SURE) Program Background*, U.S. DEP’T OF AGRIC. 1–4 (Jan. 2011), https://www.fsa.usda.gov/Internet/FSA_File/sure_bkgder_122309.pdf [hereinafter *SURE Background*].

¹⁵ U.S. DEP’T OF AGRIC., *supra* note 8.

¹⁶ SHIELDS & CHITE, *supra* note 12, at 4.

of the relevant crop year.¹⁷ The calculation of actual total revenue takes into account the direct and counter-cyclical USDA payments the farmer received, actual crop revenue received, and any insurance indemnities received.¹⁸ USDA's direct and counter-cyclical payments, or crop subsidies, are calculated based on a farmer's acreage and the type of crop grown.¹⁹ The exact, direct, or counter-cyclical payment due per acre varies significantly between various types of crop.²⁰ This method of calculation means that the amount a farmer is due under SURE may be zero, particularly when the type of crop lost is heavily subsidized.²¹ In summary, the SURE payment, in simplified form, looks something like this:

$$\text{SURE Payment} = [\text{Targeted Revenue} - \text{Actual Revenue}] \times .60$$

Targeted Revenue = crop revenue based on average market price + crop insurance payment

Actual Revenue = actual crop revenue + direct/counter-cyclical payments + insurance indemnities.²²

The average market price of a crop over the course of a crop year, also called the crop marketing period, takes approximately seven months to calculate from the end of the crop year.²³ The crop year ends at the conclusion of a particular commodity's primary harvesting period.²⁴ Due to the time delay necessary to gather the relevant market information, the SURE application periods open up approximately one year after the close of the crop marketing period.²⁵

Eligibility for a SURE payment typically hinges on whether the applicant farmer's land and destroyed crops are located in a Secretarial Designated

¹⁷ *Id.* The targeted level of revenue also takes into account the level of crop insurance coverage selected by the farmer, thereby increasing the SURE payment if the farmer selects a higher level of coverage. *Id.*

¹⁸ *SURE Backgrounder*, *supra* note 14, at 1–2.

¹⁹ *Id.* at 2.

²⁰ *Direct and Counter-Cyclical Program and Average Crop Revenue Election Program: Crop Years 2008–2012*, U.S. DEP'T OF AGRIC. 1 (Dec. 2011), http://www.fsa.usda.gov/Internet/FSA_File/fce_dcp_rates_chart.pdf.

²¹ *See id.*; *SURE Backgrounder*, *supra* note 14, at 4–5.

²² *See SURE Backgrounder*, *supra* note 14, at 4–6.

²³ *See Understanding USDA Crop Forecasts*, U.S. DEP'T OF AGRIC. 15–16 (Mar. 1999), http://www.nass.usda.gov/Education_and_Outreach/Understanding_Statistics/pub1554.pdf.

²⁴ INVESTOPEDIA, *supra* note 13.

²⁵ SHIELDS & CHITE, *supra* note 12, at 4.

Disaster County.²⁶ As previously mentioned, the 2008 Farm Bill makes SURE relief available for farmers located in these disaster counties if they experience a 10% qualifying loss.²⁷ Because this threshold is low, it effectively makes relief available to a vast number of farmers. The process by which the Secretary of Agriculture determines which counties have experienced a natural disaster affecting a given crop year was first set forth in a USDA promulgated regulation at 7 C.F.R. § 1945.20.²⁸

The original process set out in § 1945.20 first required the request of a natural disaster designation to be made by the Governor or Tribal Council of the afflicted county.²⁹ Next, the USDA National Office notified the appropriate USDA State Director, who was responsible for investigating the physical crop losses experienced in the requested county.³⁰ The USDA State Director was then to provide a formal recommendation in the form of a written report.³¹ Upon receiving the State Director's report, the National Office added additional crop yield information and sent the final report to the Secretary of Agriculture for use in making a decision on the requested natural disaster designation.³² This entire process typically took somewhere between a few months to a year.³³ For example, all Secretarial Designated Disaster Counties for the 2010 crop year were made by May 3, 2011.³⁴

On July 13, 2012, a new rule creating a new expedited process was issued in the Federal Register, striking down 7 C.F.R. § 1945.20 for all designations made on or after July 12, 2012.³⁵ The expedited process resolves two issues.³⁶ It provides for automatic designation if emergency drought levels are reached.³⁷ If emergency drought levels are not reached, then the prior designation process is still applicable with one important change: the new

²⁶ *Id.*

²⁷ *See supra* note 15 and accompanying text.

²⁸ 7 C.F.R. § 1945.20 (2009) (current version at 7 C.F.R. § 759 (2013)).

²⁹ *Id.* § 1945.20(b).

³⁰ *Id.* § 1945.20(b)(1)(ii).

³¹ *Id.* § 1945.20(b)(1)(iii). The State Director was also authorized to complete any surveys necessary to gather information on the extent of the alleged disaster. *Id.* § 1945.20(b)(2)(iv).

³² *Id.* § 1945.20(b)(3).

³³ *See* Farm Service Agency, *Secretarial Designations – SURE 2010 Disaster Incidents – Final Report*, U.S. DEPT OF AGRIC. (May 3, 2011), http://www.fsa.usda.gov/Internet/FSA_File/sure_2010gis_final050311pd.pdf.

³⁴ *Id.*

³⁵ Disaster Designation Process, 77 Fed. Reg. 41,248, (proposed July 13, 2012) (to be codified 7 C.F.R. § 759).

³⁶ *Id.* at 41,248, 41,250.

³⁷ *Id.*

disaster designation procedure removes the requirement that a Governor or Tribal Council must first request the designation, and permits the USDA State Director or Secretary of Agriculture to initiate an investigation independently.³⁸ Although the significance or efficacy of this change has yet to be seen, in theory it should speed up the designation process and give USDA the ability to independently initiate the designation process when it sees fit.³⁹

Under SURE, farmers are not “absolutely owed” payment until they (1) experience a qualifying loss, and (2) the Secretary of Agriculture designates the county through the process described in 7 C.F.R. § 1945.20, or the expedited process in 7 C.F.R. § 759.⁴⁰ The designation under § 759 is largely the same as under § 1945.20, unless “extreme” drought levels are reached, which makes the designation automatic.⁴¹ The novel issue of agency discretion over a condition necessary for payment arises when the crop is lost prepetition, yet the county where the crop was lost has yet to obtain a Secretarial Disaster Designation when the debtor farmer files a bankruptcy petition. Stated generally, the issue is, can a debtor have a legal or equitable interest in a government payment, so as to be “absolutely owing,” when agency discretion exists over a necessary qualifying condition at the time of the bankruptcy petition? This searching inquiry into the mechanics of SURE is illustrative of the factual analysis a court must engage in to determine when a government payment is “absolutely owed” to the debtor. It also demonstrates the novel issue of agency discretion that may arise.

II. PROPERTY OF THE ESTATE UNDER § 541

When a debtor files a petition for bankruptcy, a bankruptcy estate is created that serves as a means of repaying creditors.⁴² The section of the Code that defines and limits the bankruptcy estate is § 541.⁴³ Subsection (a)(1) is a broad provision, stating that a bankruptcy estate consists of “all legal or equitable interests of the debtor in property as of the commencement of the case.”⁴⁴ The bankruptcy estate therefore includes almost any asset or interest of value the debtor has at the time of filing, a broad reading that is strongly supported by

³⁸ 7 C.F.R. § 759.6 (2012).

³⁹ Disaster Designation Process, 77 Fed. Reg. 41,248, (July 13, 2012) (to be codified 7 C.F.R. § 759).

⁴⁰ See 7 C.F.R. §§ 759, 1945.20 (2009).

⁴¹ See 7 C.F.R. § 759.5 (2013).

⁴² See 11 U.S.C. § 541 (2012).

⁴³ *Id.*

⁴⁴ *Id.*

the legislative history of the Code.⁴⁵ Generally, § 541(a)(1) allows the debtor to keep property acquired postpetition, preserving the debtor's opportunity for a fresh start.⁴⁶ Subsection (a)(6), however, expands upon the definition provided in (a)(1) by bringing within the bankruptcy estate "proceeds . . . of or from property of the estate."⁴⁷ In bankruptcy cases in which the debtor has or may receive government payments, creditors frequently make two alternative arguments: that a payment received postpetition is either property of the estate under § 541(a)(1) or proceeds of property of the estate under § 541(a)(6).⁴⁸

Based on a court's interpretation of the word "proceeds" and the term "legal or equitable interest," either argument can be effective.⁴⁹ On one hand, the court could determine that a government payment program created a legal interest in the payment at some point prepetition.⁵⁰ On the other hand, bankruptcy courts can also determine a postpetition payment is "proceeds" of or from property of the estate.⁵¹ Because the Code is interpreted broadly, property of the estate can even include dead crops, making crop disaster payments "proceeds" of the debtor's prepetition, albeit useless, property.⁵²

Although the Code indicates that government payments received postpetition can be property of the bankruptcy estate under § 541, it remains unclear at exactly what point and under what line of reasoning such payments become property of the estate. Analysis of the case law shows that courts initially took an expansive view, concluding debtors have a legal or equitable interest in a government payment as long as the loss or event to which the payment is tied to occurred prepetition.⁵³ Courts reached this result even when

⁴⁵ See H.R. REP. NO. 95-595, at 367 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6004.

⁴⁶ See *Burgess v. Sikes (In re Burgess)*, 438 F.3d 493, 497 (5th Cir. 2006).

⁴⁷ 11 U.S.C. § 541(a)(6). Even when a bankruptcy court finds a crop disaster payment to be "proceeds" within the meaning of § 541(a)(6), the payment still must be "property of the estate" as defined in § 541(a)(1). This requirement is due to the language of § 541(a)(6), which states the bankruptcy estate includes "proceeds . . . of or from property of the estate." 11 U.S.C. § 541(a)(6) (emphasis added). Therefore § 541(a)(6) expressly incorporates the definition of property of the estate provided in § 541(a)(1).

⁴⁸ See *Burgess*, 438 F.3d at 496-97; *Drewes v. Lesmeister (In re Lesmeister)*, 242 B.R. 920, 923 (D.N.D. 1999).

⁴⁹ See *Burgess*, 438 F.3d at 496.

⁵⁰ See *Id.* at 498-99; *Lesmeister*, 242 B.R. at 923-24. Claims that are contingent, unliquidated or unmatured are property of the estate under § 541(a)(1) as long as the debtor has a prepetition legal right or interest. See *Lesmeister*, 242 B.R. at 924-25.

⁵¹ See *Lemos v. Rakozy (In re Lemos)*, 243 B.R. 96, 101 (Bankr. D. Idaho 1999), abrogated by *In re Stallings*, 290 B.R. 777 (D. Idaho 2003).

⁵² See *Lesmeister*, 242 B.R. at 924 (citing *Kelley v. Ring (In re Ring)*, 169 B.R. 73, 77 (Bankr. M.D. Ga. 1993), *aff'd*, 160 B.R. 692 (M.D. Ga. 1993)); *Ring*, 169 B.R. at 77.

⁵³ See *infra* notes 83-88 and accompanying text.

the authorizing legislation was passed postpetition. In the past ten years, the Fifth, Eighth, Ninth, and Eleventh Circuits have cut back on this expansive interpretation of § 541, and held that a debtor has no legal or equitable interest in a government payment until the legislation authorizing the payment is signed into law.⁵⁴ These decisions created one clear rule, but failed to articulate an overarching standard.

The relevant case law can be organized into three basic fact patterns. The first occurs when both the authorizing legislation is passed prepetition, and the debtor files an application to participate in the government payment program prepetition. The second category consists of cases in which the authorizing legislation is passed prepetition, but the debtor does not file an application to participate until after the bankruptcy petition. Finally, the third category of cases features both postpetition legislation authorizing the program, and a postpetition application on the part of the debtor.⁵⁵ Discussion of the case law organized into these factual “buckets” highlights different reasoning schemes that bankruptcy courts use when trying to determine when a debtor obtains a legal right to a government payment. It also highlights the need for a clear standard to guide the analysis of when a government payment becomes property of the estate.

A. *Prepetition Legislation and Prepetition Application Date*

At first glance it seems like this factual category should present little to no issue in the context of § 541(a) analysis. However, § 541 arguments can still arise when agency approval of a debtor’s application does not occur until after the date of the bankruptcy petition.⁵⁶ This factual pattern therefore emphasizes when a legal right or interest in a government payment may form as between three dates in time: the date of the debtor’s application, the date the agency approves the debtor’s application, or the date of contract formation.⁵⁷

⁵⁴ See *Bracewell v. Kelley (In re Bracewell)*, 454 F.3d 1234, 1239 (11th Cir. 2006); *Burgess*, 438 F.3d 507; *Drewes v. Vote (In re Vote)*, 276 F.3d 1024, 1026–27 (8th Cir. 2002); *Sliney v. Battley (In re Schmitz)*, 270 F.3d 1254, 1255 (9th Cir. 2001).

⁵⁵ A factual permutation in which the debtor’s application is filed prepetition and the authorizing legislation is passed postpetition is not possible because an application for a government payment program cannot be filed if a government payment program does not exist.

⁵⁶ See *In re Mattice*, 81 B.R. 504, 507 (Bankr. S.D. Iowa 1987).

⁵⁷ See *Schneider v. Nazar (In re Schneider)*, 864 F.2d 683, 686 (10th Cir. 1988); *Mattice*, 81 B.R. at 507.

In re Mattice is one of the earliest cases to interpret § 541(a)(1)'s temporal limitation in the context of government payment programs.⁵⁸ In *Mattice*, the court held that a debtor does not have a right to a government program payment until the debtor's application is approved.⁵⁹ Here, the debtors' application to participate in the 1986 Feed and Grain Program was approved on May 9, 1986.⁶⁰ On December 23, 1986, the debtors filed a joint petition for bankruptcy.⁶¹ The debtors' application for the 1987 Feed and Grain Program was filed prior to filing for bankruptcy, but approved after the filing on December 31, 1986.⁶² The Feed and Grain Program required the debtors to divert certain acreage from agricultural use in return for a cash payment.⁶³

USDA argued that the Feed and Grain Program payments were subject to the security agreement it had against the debtors' property, and that § 552(b) applied.⁶⁴ Section 552(b) creates an exception to § 552(a)'s rule that property acquired after filing a petition is not subject to any lien resulting from any security agreement entered into before the case.⁶⁵ Specifically, § 552(b) states that a security agreement executed before bankruptcy can extend to proceeds acquired after the filing of bankruptcy if they are proceeds *of* property the debtor acquired before the commencement of the case.⁶⁶

The court held that this exception was not applicable to the 1987 program payments because the debtors had "no rights in the 1987 program payment until their application was approved, which occurred after the filing."⁶⁷ The 1987 program payments were therefore not property of the estate under § 541(a)(1).⁶⁸ The 1986 program payments, however, were property of the estate under § 541(a)(1) because debtors obtained legal rights to the payment through approval of their application prior to filing for bankruptcy.⁶⁹ This case stands for the proposition that a legal right to government payments is created when the program application is accepted, not when it is filed.⁷⁰

⁵⁸ See *Mattice*, 81 B.R. 504.

⁵⁹ *Id.* at 507.

⁶⁰ *Id.* at 506.

⁶¹ *Id.*

⁶² *Id.* at 505.

⁶³ *Id.* at 506.

⁶⁴ *Id.* at 507.

⁶⁵ *Id.* at 506–07; see 11 U.S.C. § 552(b) (2012).

⁶⁶ *Mattice*, 81 B.R. at 507.

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ *Id.*

A similar case, *Schneider v. Nazar (In re Schneider)*, found the government payment program at issue to effectively create a contractual obligation, with continuing duties to be exchanged between the debtor and creditor.⁷¹ Due to the continuing and mutual nature of the payment program, the court held the debtor could not have a legal right or interest in the government payment until each party had signed and approved the contract that authorizes payment.⁷² In *Schneider*, the payment at issue was administered by USDA's Commodity Credit Corporation as part of a crop reduction and diversion program.⁷³ On March 12, 1984 the debtor requested an eligibility determination from the Commodity Credit Corporation.⁷⁴ On March 27, 1984 the debtor filed a petition for bankruptcy.⁷⁵ On April 16, 1984 the Government determined the debtor was eligible for the crop reduction and diversion program.⁷⁶

The court held that the debtor did not have a legal right to the payments prepetition because the contract for the payments had not been formed as of the date of the petition.⁷⁷ The eligibility agreement created an executory contract in which services were to be exchanged, because it required the debtor to limit the acres of wheat planted in return for payment.⁷⁸ Although the amount of the entitlement was liquidated and determinable at the time of the bankruptcy petition under the USDA regulations, the contract required future services by the debtor before the payment could become due.⁷⁹ The key point from this case is that payments received postpetition are not property of the estate under § 541(a)(1) if the contract was formed postpetition.⁸⁰

Mattice and *Schneider* each featured government payment programs that were contractual in nature, and required future performance by the debtor. These cases indicate that when a government payment program is contractual, a debtor does not obtain a legal or equitable interest in the government payment until the contract is formed, often through application approval.

⁷¹ *Schneider v. Nazar (In re Schneider)*, 864 F.2d 683, 686 (10th Cir. 1988).

⁷² *Id.* at 685–86.

⁷³ *Id.* at 684.

⁷⁴ *Id.* at 684 n.1.

⁷⁵ *Id.*

⁷⁶ *Id.*

⁷⁷ *Id.* at 685–86. The government did not approve the debtor's participation in the program and sign the contract until April 16, 1984, three weeks after the debtor filed for bankruptcy. *Id.* at 684 n.1.

⁷⁸ *Id.* at 685.

⁷⁹ *Id.* at 686.

⁸⁰ *Id.*

B. Prepetition Legislation and Postpetition Application Date

The second factual pattern highlights when a government payment becomes property of the estate between two different points in time: when the legislation is passed, or when the debtor files an application for payment.⁸¹ Key to this analysis is whether the debtor has a legal or equitable interest in the government payment at the time of the bankruptcy petition, or just a mere hope or expectancy.⁸²

Segal v. Rochelle is the only case in which the Supreme Court has weighed in on when a government payment becomes property of the estate.⁸³ The case was decided in 1966 and predates the Code. The Court, however, emphasized the purposes of the old Bankruptcy Act, explaining that the “bankruptcy estate” should be broadly interpreted.⁸⁴ An interest should not be deemed outside its reach because it was novel or contingent at the time the debtor filed for bankruptcy.⁸⁵ The Court articulated a “sufficiently rooted” test to determine if tax refunds tied to prepetition losses, but received postpetition, were property of the bankruptcy estate.⁸⁶ The Court held that the tax refund claims were “sufficiently rooted” in the prebankruptcy past, not entangled with the debtor’s fresh start, and should be considered a part of the bankruptcy estate.⁸⁷ The “sufficiently rooted” test from *Segal* does not find a particular date or event to determine when a debtor acquires a legal right to payment, but rather uses a purpose-based approach in which the facts as a whole must be analyzed.⁸⁸

The more modern, post-Code case, *Kelley v. Ring (In re Ring)*, held that although the debtor did not apply for disaster payment benefits until after filing for bankruptcy, the payments were property of the estate because they qualified as proceeds under § 541(a)(6).⁸⁹ In *Ring*, the debtor experienced crop losses during the 1990 and 1991 crop years.⁹⁰ The legislation authorizing the disaster payments at issue was signed into law on December 12, 1991.⁹¹ On

⁸¹ See *Boyett v. Moore (In re Boyett)*, 250 B.R. 817, 822 (Bankr. S.D. Ga. 2000); *Drewes v. Lesmeister (In re Lesmeister)*, 242 B.R. 920, 925 (Bankr. D.N.D. 1999).

⁸² See *Boyett*, 250 B.R. at 821.

⁸³ *Segal v. Rochelle*, 382 U.S. 375 (1966).

⁸⁴ *Id.* at 379.

⁸⁵ *Id.* at 380.

⁸⁶ *Id.* at 376, 379.

⁸⁷ *Id.*

⁸⁸ See *id.*

⁸⁹ See *Kelley v. Ring (In re Ring)*, 169 B.R. 73, 77 (Bankr. M.D. Ga. 1993).

⁹⁰ See *id.* at 74.

⁹¹ *Id.*

January 10, 1992, the debtor filed his petition for bankruptcy, and did not list in his schedule of assets a claim for crop disaster payments.⁹² In February of 1992, the debtor applied for the crop disaster benefits, and on April 15, 1992, the application was approved, and the debtor was paid \$58,987.00.⁹³

The court interpreted precedent as framing the relevant issue to be whether the debtor's postpetition entitlements under the disaster assistance program qualified as "proceeds" under § 541(a)(6).⁹⁴ The court found the disaster payments "analogous to insurance payments for crop loss or damage."⁹⁵ The definition of proceeds under the relevant UCC provision at the time, UCC § 9-306, expressly included "insurance payable by reason of loss or damage to the collateral."⁹⁶ The determinative factor for the court was that the property lost, the crop, was prepetition property that the debtor had a legal right or interest in prior to the commencement of the case.⁹⁷ Therefore, "proceeds" of the lost crop became part of the bankruptcy estate at the time the petition was filed.⁹⁸ The purpose of the disaster payment is to compensate the debtor for crop losses, much like a postpetition insurance payment.⁹⁹ Like *Segal, Ring* did not find a certain date in time to dictate when a debtor obtains a legal or equitable interest in a government payment.¹⁰⁰ *Ring* instead focused on the language of the Code and the UCC, applying the statutory provisions to the facts of the given case.¹⁰¹

The issue raised in the next case, *Drewes v. Lesmeister (In re Lesmeister)*, is whether a government payment is property of the estate when the legislation is passed prepetition, but the regulations are promulgated postpetition.¹⁰² In *Lesmeister*, the debtors argued that because the federal regulations establishing the procedures for payment under the Crop Loss Disaster Assistance Program (CLDAP) were promulgated postpetition, the disaster payments were not property of the estate under § 541(a).¹⁰³ In *Lesmeister*, the Agricultural and Rural Redevelopment Act that authorized CLDAP funding was signed into law

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *Id.* at 75.

⁹⁵ *Id.* at 76.

⁹⁶ *Id.* at 76 n.4 (citations omitted).

⁹⁷ *Id.* at 77.

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ See *Segal v. Rochelle*, 382 U.S. 375, 511, 515 (1966); *Ring*, 169 B.R. at 75 n.3, 76 n.4.

¹⁰¹ *Ring*, 169 B.R. at 75 n.3, 76 n.4.

¹⁰² *Drewes v. Lesmeister (In re Lesmeister)*, 242 B.R. 920, 925 (Bankr. D.N.D. 1999).

¹⁰³ *Id.* at 923.

after the debtors' crop loss on October 21, 1998.¹⁰⁴ On February 10, 1999, the debtor farmer filed a bankruptcy petition.¹⁰⁵ On April 15, 1999, USDA promulgated and issued the final CLDAP regulations.¹⁰⁶

The court stated that to determine whether a legally cognizable property right exists within the meaning of § 541(a)(1), one must focus on whether all events establishing the debtor's right to payment occurred prepetition.¹⁰⁷ Because it was undisputed that the debtors lost their crop prepetition, the issue became whether the debtors had a sufficient "legal interest" in the crop disaster payment at the time of the bankruptcy petition.¹⁰⁸ Specifically, was a legal interest in the program payments created by the passage of the enabling act in October of 1998, or upon promulgation of the final regulations in April of 1999?¹⁰⁹

The court held that a legal interest was created when the bill authorizing the crop payment program was signed into law.¹¹⁰ The statutory scheme dictated the substance of the payments, and the regulations only laid out the procedural mechanisms for applying and calculating the payment amount.¹¹¹ All of the events necessary to establish the debtor's right to payment occurred prepetition, with the last necessary condition being passage of the legislation.¹¹² What the debtor had at the time of the bankruptcy petition was a contingent claim, closely analogous to an "action for damages not yet put into suit."¹¹³ Furthermore, the court refused to subject the Code's definition of § 541 to the narrower parameters of the UCC.¹¹⁴ The court noted that although the UCC definition of proceeds is useful, it is by no means mandatory to use.¹¹⁵ Rather, to interpret § 541(a)(6) it is essential to accept the notion that "when a debtor acquires an interest in property . . . § 541(a)(1) includes any legal or equitable interest which is inherently a far more expansive concept than the [UCC] definition of proceeds."¹¹⁶

¹⁰⁴ *Id.* at 922–23.

¹⁰⁵ *Id.* at 922.

¹⁰⁶ *Id.* at 922–23.

¹⁰⁷ *Id.* at 924–25.

¹⁰⁸ *See id.* at 924.

¹⁰⁹ *Id.* at 925 (referring to attachment which is a "prerequisite to enforcement of a security interest").

¹¹⁰ *Id.*

¹¹¹ *Id.* at 925–26.

¹¹² *Id.* at 925.

¹¹³ *Id.* at 924–25.

¹¹⁴ *Id.* at 924.

¹¹⁵ *Id.*

¹¹⁶ *Id.*

Although *Lesmeister* is similar to *Ring* in that no date is determinative as to when a debtor obtains a legal interest in a government payment, *Lesmeister* found the payment program's proceeds to be property of the estate by focusing on the relevant § 541 provisions rather than by making a comparison to insurance payments.¹¹⁷ What is interesting is the language of the *Lesmeister* test, which examines whether all acts and events giving rise to the debtors' right to participate in the program occurred prepetition.¹¹⁸

The most recent case under this factual bucket is *Boyett v. Moore (In re Boyett)*.¹¹⁹ In *Boyett*, the court explicitly rejected the argument that a debtor does not have a legal or equitable interest in a crop disaster payment until his application is filed or approved.¹²⁰ Here, the legislation authorizing the CLDAP program became law on October 21, 1998.¹²¹ On February 16, 1999 the debtor petitioned for bankruptcy relief, prior to filing a CLDAP application on April 6, 1999.¹²² The regulations for CLDAP became effective on April 15, 1999.¹²³

The debtor argued that although the CLDAP program was enacted prior to his bankruptcy filing, he did not have a legal interest in the payment at the time of filing because the regulations and sign-up period were not established until after the date of petition.¹²⁴ The court championed the *Lesmeister* decision, reiterating that a debtor has a legal or equitable interest in a government payment when all events giving rise to the benefit occurred prepetition.¹²⁵ The court therefore considered the payment to be property of the estate under § 541(a)(1) because all events giving rise to the benefit, including the authorizing legislation and crop loss, occurred prepetition.¹²⁶

In addition, the court reaffirmed that disaster payments based on prepetition losses are additional compensation for crops grown prebankruptcy, and

¹¹⁷ Compare *id.* (the Code's definition of "interest" is much more expansive than the UCC's definition of "proceeds"), with *Kelley v. Ring (In re Ring)*, 169 B.R. 73, 77 (M.D. Ga. 1993) (arguing that under the UCC, disaster relief program payments are like insurance payments).

¹¹⁸ *Lesmeister*, 242 B.R. at 926.

¹¹⁹ *Boyett v. Moore (In re Boyett)*, 250 B.R. 817 (S.D. Ga. 2000).

¹²⁰ See *id.*

¹²¹ *Id.* at 818.

¹²² *Id.*

¹²³ *Id.*

¹²⁴ *Id.* at 819.

¹²⁵ See *id.* at 819–20 (citing *Lemos v. Rakozy (In re Lemos)*, 243 B.R. 96, 100–01 (Bankr. D. Idaho 1999), *abrogated by In re Stallings*, 290 B.R. 777 (Bankr. D. Idaho 2003)).

¹²⁶ *Boyett*, 250 B.R. at 820.

therefore are proceeds of the estate pursuant to § 541(a)(6).¹²⁷ The court also distinguished crop disaster payment programs from contractual, or payment-in-kind subsidy programs, like the one at issue in *Mattice*.¹²⁸ In this case, CLDAP payments are due to a farmer once all the conditions for payment are met.¹²⁹ At the time of filing in this case, debtor's entitlement to payment existed because the program had been enacted and the debtor had lost his crop, despite the fact that the debtor's payment could not be immediately realized.¹³⁰ Thus, the debtor's postpetition application for payment was held to be "merely a ministerial act, not a qualifying event."¹³¹

The test emerging from the cases in this factual category appears to be whether "all acts and events giving rise to [the debtor's] right to participate in the program arose [prepetition]."¹³² Similar to the first factual bucket, there is no specific moment in time when the debtor obtains a legal or equitable interest in a government payment.¹³³ However, the court in *Boyett* contrasted payment in kind programs with subsidy or entitlement programs, and explicitly rejected the use of the postpetition program application date as a qualifying event determinative to § 541(a) analysis of entitlement programs.¹³⁴ Although a clear date may not be settled, at least one option, a postpetition program application date, has been rejected.

C. Postpetition Legislation and Postpetition Application Date

In the 2000s, the issue of whether a government payment authorized by postpetition legislation could be considered property of the estate was widely discussed and litigated. Early decisions took an expansive approach, holding that any postpetition crop disaster payment arising from a prepetition crop loss

¹²⁷ *Id.* (citing *Lemos*, 243 B.R. at 100–01).

¹²⁸ Compare *Boyett*, 250 B.R. at 820 (debtor made no claims to a contract with the government), with *In re Mattice*, 81 B.R. 504, 506 (S.D. Iowa 1987) (farmers entered into agreements to not plant crops with the government in exchange for monetary compensation). Payment-in-kind programs are executory contracts because they involve an unperformed exchange of services, as the government pays the farmer in exchange for his promise not to plant crops. *Boyett*, 250 B.R. at 822 (citing *Schneider v. Nazar (In re Schneider)* 864 F.2d 683, 685 (10th Cir. 1988); *In re Schmaling*, 783 F.2d 680, 683 (7th Cir. 1986)).

¹²⁹ *Boyett*, 250 B.R. at 822.

¹³⁰ *Id.*

¹³¹ *Id.*

¹³² *Drewes v. Lesmeister (In re Lesmeister)*, 242 B.R. 920, 926 (D.N.D. 1999); see *Boyett*, 250 B.R. 817 (citing *Lemos*, 243 B.R. at 99).

¹³³ See generally *Lesmeister*, 242 B.R. 920; *Mattice*, 81 B.R. 504.

¹³⁴ *Boyett*, 250 B.R. at 822.

was a contingent property interest within the scope of § 541(a)(1) or (6).¹³⁵ The *Lemos v. Rakozy* (*In re Lemos*) decision is perhaps the best example of this approach.¹³⁶ The court in *Lemos* held that crop disaster payments authorized by postpetition legislation, were “so rooted” in prepetition crop losses as to constitute property of the bankruptcy estate.¹³⁷ The court reasoned the debtor was entitled to the payments only as a result of events that occurred prebankruptcy, with *no* substantial event occurring postbankruptcy that limited or changed his eligibility.¹³⁸ At the time the bankruptcy petition was filed, the debtor had a contingent interest in the prospect of a federal program being adopted to compensate him for his crop losses.¹³⁹

Later decisions saw courts reconsider when a crop loss payment can be considered property of the bankruptcy estate. The expansive approach demonstrated by *Lemos* was curtailed by a new bright line rule that crop loss payments cannot be considered property of the bankruptcy estate unless the legislation authorizing the payment was enacted prepetition.¹⁴⁰ The driving principle behind this theory is that a debtor cannot have a contingent interest in a government payment not yet authorized by Congress.¹⁴¹

This bright line rule was first articulated by the Eighth Circuit in *Drewes v. Vote* (*In re Vote*).¹⁴² In *Vote* the debtor filed a bankruptcy petition on September 7, 1999.¹⁴³ Subsequent to the filing, on October 22, 1999, Congress enacted the Omnibus Consolidated Appropriations Act of 2000.¹⁴⁴ The Act provided payments for all farmers enrolled in 7-year production contracts through USDA’s Market Loss Assistance Program (MLAP), and funded The Crop Disaster Program (CDP) for the 1999 crop year.¹⁴⁵ On November 3,

¹³⁵ See *Lemos*, 243 B.R. at 99.

¹³⁶ See generally *id.*

¹³⁷ *Id.* at 100 (quoting *Battley v. Schmitz* (*In re Schmitz*), 224 B.R. 117 (Bankr. D. Alaska 1998)). The “so rooted” test and its purpose driven approach is very similar to, and draws heavily upon, the Supreme Court’s “sufficiently rooted” test set forth in *Segal. Id.* (quoting *Battley v. Schmitz*, (*In re Schmitz*), 224 B.R. 117, 124 (Bankr. D. Alaska 1998) (citing *Segal v. Rochelle*, 382 U.S. 375, 380 (1966))).

¹³⁸ *Lemos*, 243 B.R. at 98–99.

¹³⁹ *Id.* at 99.

¹⁴⁰ See *Drewes v. Vote*, (*In re Vote*), 261 B.R. 439, 443–44 (B.A.P. 8th Cir. 2001).

¹⁴¹ See generally *Bracewell v. Kelley* (*In re Bracewell*), 454 F.3d 1234, 1236, 1246 (11th Cir. 2006); *Burgess v. Sikes* (*In re Burgess*), 438 F.3d 493, 495 (5th Cir. 2006); *Vote*, 261 B.R. at 443–44.

¹⁴² See *Vote*, 261 B.R. at 443–44.

¹⁴³ *Id.* at 440.

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

1999, the debtor farmer received a MLAP payment, followed by two CDP payments: one on February 9, 2000, and another on April 7, 2000.¹⁴⁶

The court described the issue of whether a postpetition payment, enacted by postpetition legislation, but rooted in prepetition crop losses, should be considered property of the estate as an “extremely close call.”¹⁴⁷ The court considered two alternatives. On one hand, it reasoned that the broad “sufficiently rooted” reasoning of *Segal* might support a finding that the CDP payments in this case were property of the estate.¹⁴⁸ On the other hand, it reasoned that the holding in *Segal* is limited to tax refunds, and therefore, is inapplicable to government payment programs, like MLAP and CDP.¹⁴⁹ The court concluded *Segal* was of limited applicability, and held that the debtor had only an expectation or hope that Congress would pass crop relief legislation at the time he filed for bankruptcy.¹⁵⁰ Such an expectation did “not rise to the level of a ‘legal or equitable interest’ in property such that it might be considered property of the estate under § 541(a)(1).”¹⁵¹

Following the decision in *Vote*, other circuit courts heard similar cases presenting the issue of whether crop disaster payments authorized by postpetition legislation were property of the estate.¹⁵² For example, *Burgess v. Sikes (In re Burgess)*, a case that strongly endorsed *Vote*, held that a debtor did not obtain a legal interest in a government payment until the postpetition legislation authorizing the payment was passed.¹⁵³ The debtor in *Burgess* filed a petition for bankruptcy in August of 2002.¹⁵⁴ In February of 2003, Congress passed the Agricultural Assistance Act.¹⁵⁵ The legislation “provided for crop disaster-relief-payments to qualifying farmers for 2001 or 2002 crop losses.”¹⁵⁶

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* at 443.

¹⁴⁸ *Id.* at 442–44 (quoting *Segal v. Rochelle*, 382 U.S. 375, 379–81 (1966)).

¹⁴⁹ *Id.* at 443–44. The court revisited the Code’s legislative history to determine if *Segal*’s definition of property was dispositive. Surprisingly, the court discovered an alternate interpretation previously overlooked within the congressional record: “The result in *Segal v. Rochelle* . . . is followed, and the right to a *refund* is property of the estate.” Because of *Segal*’s “questionable applicability”, and the existence of a concrete date as to when the debtor became legally entitled to the disaster relief payments, the court did not include the payments within the property of the estate. *Id.*

¹⁵⁰ *Id.* at 444.

¹⁵¹ *Id.*

¹⁵² See generally *Bracewell v. Kelley (In re Bracewell)*, 454 F.3d 1234 (11th Cir. 2006); *Burgess v. Sikes (In re Burgess)*, 438 F.3d 493 (5th Cir. 2006); *In re Andrews*, 386 B.R. 871 (Bankr. D. Utah 2008).

¹⁵³ *Burgess*, 438 F.3d at 494, 499.

¹⁵⁴ *Id.* at 495.

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

The debtor applied for a relief payment in August of 2003, and shortly thereafter USDA issued a check to the bankruptcy trustee for \$24,829.¹⁵⁷ The debtor filed a Motion for Turnover arguing the check was not property of the bankruptcy estate.¹⁵⁸

A split court held that crop disaster payments authorized by postpetition legislation are not property of the estate under either § 541(a)(1) or (6).¹⁵⁹ The court added that it could “find no case in which a pure loss with no attendant potential benefit was included as property of the estate.”¹⁶⁰ Furthermore, the court concluded that “for the temporal limitation to have any meaning at all, [the debtor] must have a prepetition interest in the disaster-relief payment [itself],” as one cannot have a legal interest in a crop loss.¹⁶¹ Therefore, to have a legal interest in a government payment, the authorizing legislation must have been passed prepetition.¹⁶² Like the court in *Vote*, the court in *Burgess* found that *Segal* did not survive enactment of the Code.¹⁶³

Burgess featured a strong dissent, with seven out of the sixteen judges dissenting.¹⁶⁴ The dissent found § 541(a)(1) to describe property of the estate “in the broadest possible terms,” and § 541(a)(6) to reach “all conceivable [postpetition] returns yielded by the debtor’s property.”¹⁶⁵ The dissent also looked to Supreme Court precedent for support, finding that the Court routinely concluded that property of the estate must be broadly interpreted.¹⁶⁶ The dissent added that *Segal* affirms the idea that a loss prior to bankruptcy can later yield property to be included in the bankruptcy estate.¹⁶⁷ The fact that *Segal* was mentioned in the legislative history of the Code supports the proposition that it should be followed, and not disavowed.¹⁶⁸ *Burgess* highlights two approaches to § 541 analysis in the context of government

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

¹⁵⁹ *Id.* at 495, 508.

¹⁶⁰ *Id.* at 503.

¹⁶¹ *Id.*

¹⁶² *See id.*

¹⁶³ *Id.* at 498–99.

¹⁶⁴ *Id.* at 508 (Jones, C.J., dissenting).

¹⁶⁵ *Id.*

¹⁶⁶ *Id.* (citing *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983)).

¹⁶⁷ *Id.* at 511 (citing *Segal v. Rochelle*, 382 U.S. 375, 379 (1966)).

¹⁶⁸ *See id.* at 508 (citing H.R. REP. NO. 95-595, at 367 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6323).

payments: an expansive analysis, and a bright line approach in which a program authorized by postpetition legislation is a mere expectation.¹⁶⁹

A few months after the Fifth Circuit's decision in *Burgess*, the Eleventh Circuit heard a similar case in *Bracewell v. Kelley (In re Bracewell)*.¹⁷⁰ *Bracewell* also held that crop disaster payments authorized by postpetition legislation, but based on prepetition losses, are not property of the estate.¹⁷¹ The court reasoned that when legislation is passed postpetition the debtor has "only a hope" that the legislation would be passed, and therefore has no right or interest that constitutes property.¹⁷²

The debtor in *Bracewell* lost a substantial amount of his 2001 crop due to a drought.¹⁷³ Unable to repay his debts, the debtor filed for bankruptcy on May 29, 2002.¹⁷⁴ The Emergency Farmer and Rancher Assistance Act, signed into law on February 20, 2003, provided for monetary assistance to farmers who suffered losses to their 2001 or 2002 crops due to weather-related disasters or emergency conditions.¹⁷⁵ Shortly thereafter the debtor applied for payment and received \$41,566 while his bankruptcy case was still pending.¹⁷⁶

The trustee argued that the payment was property of the estate pursuant to § 541(a)(6), claiming that it was proceeds of the estate, analogous to insurance payments.¹⁷⁷ The court reasoned that "there is a difference between insurance payments stemming from the destruction of property" and "disaster assistance authorized after the estate was created."¹⁷⁸ The destroyed crops did not fit within the meaning of the term proceeds because they could not create anything of value which could be exchanged or sold.¹⁷⁹ Given this reasoning, the court held that if the disaster legislation is not law at the time of filing, the debtor cannot have a legal or equitable interest in the payment.¹⁸⁰ The court also found the two previous circuit court decisions in *Vote* and *Burgess* to be persuasive support for the proposition that no legal or equitable interest can

¹⁶⁹ See *id.*

¹⁷⁰ See *Bracewell v. Kelley (In re Bracewell)*, 454 F.3d 1234, 1247 (11th Cir. 2006).

¹⁷¹ See *id.*

¹⁷² *Id.* at 1239.

¹⁷³ *Id.* at 1236.

¹⁷⁴ *Id.* at 1247.

¹⁷⁵ *Id.* at 1236.

¹⁷⁶ *Id.* at 1237.

¹⁷⁷ *Id.* at 1246.

¹⁷⁸ *Id.*

¹⁷⁹ *Id.* at 1247.

¹⁸⁰ *Id.* at 1246.

exist until the authorizing legislation is signed into law.¹⁸¹ Thus, § 541(a)(1)'s temporal limitation controls the analysis, rather than *Segal's* "sufficiently rooted" pre-Code test.¹⁸²

The one dissenting judge in *Bracewell* closely followed the dissent in *Burgess*.¹⁸³ The dissent emphasized *Segal's* "sufficiently rooted" test, and believed that the decision survived the passage of the Code.¹⁸⁴ The dissent also noted that both the current and previous versions of the Code featured an expansive definition of property of the estate, lending credence to the notion that *Segal* and a broad interpretation of property of the estate survives in § 541.¹⁸⁵

The *Vote*, *Burgess*, and *Bracewell* opinions have drawn a line, holding that a debtor cannot have a legal or equitable interest in a government payment if the authorizing legislation was not signed into law prior to the bankruptcy filing.¹⁸⁶ These decisions reasoned that a debtor has no way of knowing whether Congress would in fact confer payment, and could only hope that relief legislation would be passed.¹⁸⁷

The general issue left unanswered by cases analyzing § 541 is at what precise point does a government payment become a legal entitlement or property interest. The opinions seem to suggest three general possibilities: (1) at the passage of the legislation; (2) at the approval of the application or at the formation of a contract; or (3) when the debtor satisfies all the requirements for payment.¹⁸⁸ The one bright-line rule that has emerged is that crop disaster payments authorized by postpetition legislation are under no circumstances considered property of the bankruptcy estate.

¹⁸¹ See *id.* at 1238 (citing *Burgess v. Sikes (In re Burgess)*, 438 F.3d 493, 498 (5th Cir. 2006); *Drewes v. Vote (In re Vote)*, 261 B.R. 439, 443 (B.A.P. 8th Cir. 2001)).

¹⁸² See *id.* (citing *Burgess*, 438 F.3d at 498; *Vote*, 261 B.R. at 443).

¹⁸³ See *Bracewell*, 454 F.3d at 1249–50 (Pryor, J., dissenting); *Burgess*, 438 F.3d at 508–11 (Jones, C.J., dissenting).

¹⁸⁴ *Bracewell*, 454 F.3d at 1249–50 (Pryor, J., dissenting).

¹⁸⁵ *Id.* at 1050–51.

¹⁸⁶ See generally *id.* (citing *Burgess*, 438 F.3d at 498; *Vote*, 261 B.R. 439).

¹⁸⁷ Susan A. Schneider, *Who Gets the Check: Determining When Federal Farm Programs Are Property of the Estate*, 84 NEB. L. REV. 469, 503 (2005).

¹⁸⁸ See *Bracewell*, 454 F.3d at 1238 (citing *Burgess*, 438 F.3d at 498; *Vote*, 261 B.R. at 443).

III. RIGHT TO SETOFF UNDER § 553

The right of a creditor to setoff mutual debts is set forth in § 553.¹⁸⁹ Section 553 does not purport to create a right to setoff but rather “preserves” a pre-existing right to setoff.¹⁹⁰ The USDA’s right to setoff in bankruptcy is authorized by 7 C.F.R. § 631.20.¹⁹¹

In order for a creditor’s prepetition right of setoff to survive in bankruptcy under § 553(a), three requirements must be satisfied: (1) the parties must owe each other mutual debts, (2) the mutual debts must have arisen [prepetition], and (3) the creditor’s claim cannot fall within one of the three statutory exceptions listed in § 553(a)(1)–(3).¹⁹²

The main issue presented in the context of government payment programs is whether the mutual debts arose prepetition.¹⁹³ This occurs because a debtor may experience a prepetition loss, but will not file an application for payment until after a bankruptcy petition is filed, raising the issue of when the debt actually arose.¹⁹⁴ There appears to be a clearer standard under § 553 than under § 541. The right to setoff in § 553 articulates that the payment must be “owing” at the time of the petition for a creditor to possess the right to setoff. Again, discussion of the case law will fall into the factual buckets discussed previously.

A. *Prepetition Legislation and Prepetition Application Date*

The two cases discussed in this factual bucket use similar “absolutely owing” and “all transactions necessary” tests to determine when a debtor obtains a legal or equitable interest in a government payment in the context of setoff, indicating a clearer standard.¹⁹⁵ The first case is *Moratzka v. Agricultural Stabilization and Conservation Service (In re Matthieson)*.¹⁹⁶ In *Matthieson*, six debtors were enrolled in the Federal Crop Deficiency Program

¹⁸⁹ See 11 U.S.C. § 553 (2012).

¹⁹⁰ See *id.*

¹⁹¹ 7 C.F.R. § 631.20 (2013).

¹⁹² *United Serv. Prot. Corp. v. Bill Heard Enters.*, (In re Bill Heard Enters.), 438 B.R. 745, 750 (Bankr. N.D. Ala. 2010) (citations omitted).

¹⁹³ See generally *In re Young*, 144 B.R. 45, 45–47 (Bankr. N.D. Tex. 1992) (discussing the issue of whether the mutual debt arose prepetition).

¹⁹⁴ See generally *Motion to Lift Stay and for Offset, In re Farmer*, No. 10-09353 (Bankr. E.D.N.C. 2012).

¹⁹⁵ *Moratzka v. Agric. Stabilization & Conservation Serv. (In re Matthieson)*, 63 B.R. 56, 58–59 (D. Minn. 1986); *United States v. Gerth*, 991 F.2d 1428, 1434–35 (8th Cir. 1993).

¹⁹⁶ See *Matthieson*, 63 B.R. 56.

for the 1984 growing season.¹⁹⁷ After enrolling in the program, but before receiving the payments, the debtors filed for bankruptcy.¹⁹⁸ Each of the debtors also owed the government prepetition debts.¹⁹⁹

The sole issue was whether the deficiency payments owed by USDA to the enrolled debtors were prepetition obligations and therefore subject to setoff against the claim USDA had against each of the debtors.²⁰⁰ The court reasoned that a government payment may be a prepetition debt for purposes of mutuality notwithstanding the fact that the payment is immature.²⁰¹ In other words, a creditor's right of setoff may be asserted in a bankruptcy case even though at the time the petition is filed the debt is "absolutely owing" but is not yet presently due.²⁰² Furthermore, when an obligation exists prior to bankruptcy, it is irrelevant that it is unliquidated until after the petition is filed.²⁰³

The court engaged in a factual analysis and found that the debtors satisfied all the conditions for payment prior to filing for bankruptcy.²⁰⁴ The deficiency program agreement did not contain any conditions precedent that remained unsatisfied as of the petition date.²⁰⁵ Although the program did require certain contractual duties to be performed by the debtor, these were contractual promises rather than conditions precedent.²⁰⁶

In the second case, *United States v. Gerth*, the Eighth Circuit considered the USDA's motion to modify the automatic stay to permit setoff.²⁰⁷ In *Gerth*, the USDA owed the debtor certain conservation reserve payments, and wished to setoff these payments against a debt the debtor had previously incurred with the USDA.²⁰⁸ The debtor however argued that the conservation reserve payment did not arise prepetition because the program's funds were annually

¹⁹⁷ *Mathieson*, 63 B.R. at 56.

¹⁹⁸ *Id.*

¹⁹⁹ *Id.*

²⁰⁰ *Id.*

²⁰¹ *Id.* at 59.

²⁰² *Id.* at 58. (citing *Traders Bank of Kan. City v. Stonitsch (In re Isis Foods, Inc.)*, 24 B.R. 75, 76 (Bankr. W.D. Mo. 1982). A debt is regarded as "absolutely owing" when there can be no question about the existence of the debt. *Isis Foods*, 24 B.R. at 76.

²⁰³ *Mathieson*, 63 B.R. at 59 (citing *Mich. Consol. Gas Co. v. Fred Sanders Co. (In re Fred Sanders Co.)*, 33 Bankr. 310, 312 (Bankr. E.D. Mich. 1983)).

²⁰⁴ *Id.*

²⁰⁵ *Id.* at 60.

²⁰⁶ *Id.* at 59.

²⁰⁷ *United States v. Gerth*, 991 F.2d 1428, 1429 (8th Cir. 1993).

²⁰⁸ *Id.* at 1429–30.

appropriated, and at the time the bankruptcy petition was filed the relevant crop year's funds had not been appropriated to the USDA.²⁰⁹

The Eighth Circuit held that “dependency on a [postpetition] event does not prevent a debt from arising [prepetition].”²¹⁰ The court added that a claim is not deemed to be postpetition merely because it is contingent, unliquidated or unmatured on the date of the bankruptcy petition.²¹¹ “A debt can be absolutely owing [prepetition] even though that debt would never have come into existence [but] for [postpetition] events.”²¹² A key factor for determining when a government debt is owed prepetition is whether “all transactions necessary” for the USDA’s liability took place prior to the farmer debtor’s filing of the bankruptcy petition.²¹³ Here, the court found that all transactions necessary took place upon the debtor’s entry into the program because both parties signed the conservation program contract prepetition.²¹⁴ The postpetition appropriation of funds by the USDA did not affect the farmer’s eligibility.²¹⁵

The two cases discussed use similar “absolutely owing” and “all transactions necessary” tests to determine when a debtor obtains a legal or equitable interest in a government payment in the context of a setoff.²¹⁶ The cases also demonstrate that continuing contractual obligations and federal appropriation of funds do not affect a debtor’s eligibility and therefore do not sway analysis under § 553.²¹⁷

B. Prepetition Legislation and Postpetition Application Date

The one case in this factual bucket, *In re Gibson*, similarly articulates a clear “absolutely owing” rule.²¹⁸ In *Gibson*, the USDA argued it was entitled to offset loan deficiency payments worth \$18,000, which were applied for and received by the debtors postpetition.²¹⁹ The debtors opposed the government’s motion to lift the automatic stay, contending that their right to the loan

²⁰⁹ *Id.* at 1432.

²¹⁰ *Id.* at 1433.

²¹¹ *Id.*

²¹² *Id.* at 1434.

²¹³ *See id.* at 1435.

²¹⁴ *Id.*

²¹⁵ *Id.* at 1434–35.

²¹⁶ *Id.*; *Moratzka v. Agric. Stabilization & Conservation Serv. (In re Matthieson)*, 63 B.R. 56, 58–59 (D. Minn. 1986).

²¹⁷ *See Gerth*, 991 F.2d at 1434–35; *Matthieson*, 63 B.R. at 59.

²¹⁸ *See In re Gibson*, 308 B.R. 763, 765 (N.D. Tex. 2002).

²¹⁹ *Id.*

deficiency payments was a postpetition right, thereby foreclosing setoff under § 553.²²⁰

The court stated that for a debt to arise prepetition, such debt must have been “absolutely owing” prepetition.²²¹ This does not mean the debt must have been due prepetition, or that the creditor must have initiated collection of the debt prepetition.²²² The court added that “it does not matter that [the] debt was contingent, unliquidated, or unmatured as of the date of the filing,” but “what matters is whether the liability accrued [prepetition].”²²³ The court then looked carefully at the eligibility requirements for the disaster payment, engaging in a factual inquiry.²²⁴ Ultimately, the court held that the debtors met all the program requirements prepetition, and that the debtors’ right to a payment accrued prepetition.²²⁵ The debtors only had to make the decision whether to exercise the right postpetition.²²⁶ The act of applying for a payment does not, by itself, make the government’s liability for the payment a postpetition debt.²²⁷ Rather, the right to payment is deemed to accrue prepetition if the debtors satisfy all requirements for obtaining payment under a government program prepetition.²²⁸ Therefore, setoff could be validly exercised by the USDA under 7 C.F.R. § 1412.406.²²⁹

Other courts have not disagreed with the rule articulated in *Gibson*.²³⁰ It therefore appears to put forth a bright line rule as to when a crop disaster payment “arose” for the purposes of setoff under § 553 of the Code: it is immaterial whether a debtor files a postpetition application as long as the payment was “absolutely owing” as of the petition date.²³¹

Gibson furthermore suggests that this rule is not limited to the crop disaster payment context, and may extend to government payments generally.²³² *Gerth*

²²⁰ *Id.*

²²¹ *Id.* at 768–69 (citing *Braniff Airways Inc. v. Exxon Co.*, 814 F.2d 1030, 1035 (5th Cir.1987)).

²²² *Id.* at 766.

²²³ *Id.* at 767.

²²⁴ *Id.* at 768–69.

²²⁵ *Id.* at 768–70.

²²⁶ *Id.* at 769.

²²⁷ *Id.*

²²⁸ *Id.*

²²⁹ *Id.* at 766.

²³⁰ See generally *In re Farmer*, No. 10-09353, 2012 WL 4905480 (Bankr. E.D.N.C. 2012); *In re U.S. Aeroteam, Inc.*, 327 B.R. 852 (Bankr. S.D. Ohio 2005).

²³¹ See *Gibson*, 308 B.R. at 763.

²³² *Id.* at 767–69.

and *Mathieson* seem to support this test by adopting an approach that requires “all transactions necessary” to occur prior to the debtor’s filing for bankruptcy.²³³ The test for determining whether the government has a right to setoff with respect to government payments is therefore clearer under § 553 than under § 541 property of the estate analysis.

IV. RECENT CASE LAW (2008–PRESENT)

As discussed earlier, circuit court cases in the 2000s set a bright line rule that payments authorized by postpetition legislation are not property of the estate under § 541.²³⁴ These decisions, however, did not explicitly state at what point a debtor obtains a legal or equitable interest in a government payment.²³⁵ In terms of the right to setoff under § 553, there appears to be a clearer rule: that the payment must be “absolutely owing” at the time of the bankruptcy petition.²³⁶

Since 2008, however, few cases related to these issues have been decided. A contributing reason may be an increase in settlements.²³⁷ The few cases on point, which deal with SURE payments, reveal the lack of a clear standard as to when government payments become property of the bankruptcy estate.²³⁸ Furthermore, debtors may be successfully arguing that a legal interest in a government payment does not arise until the program application date or the statutory authorization date.²³⁹

This reasoning is inconsistent with the Code because these events are not determinative of when a debtor has a legal interest in a government payment.²⁴⁰ Instead a more searching factual inquiry is necessary. Recent cases deal with only two of the factual buckets: prepetition legislation followed by a

²³³ See *United States v. Gerth*, 991 F.2d 1428, 1435 (8th Cir. 1993); *Moratzka v. Agric. Stabilization & Conservation Serv. (In re Mathieson)*, 63 B.R. 56, 58–59 (D. Minn. 1986).

²³⁴ See *supra* text accompanying notes 138–48, 150–60, 167–79. See generally *In re Gibson*, 308 B.R. 763 (Bankr. N.D. Tex. 2002).

²³⁵ See generally *Bracewell v. Kelley (In re Bracewell)*, 454 F.3d 1234 (11th Cir. 2006); *Burgess v. Sikes (In re Burgess)*, 438 F.3d 493 (5th Cir. 2006); *Drewes v. Vote, (In re Vote)*, 261 B.R. 439 (B.A.P. 8th Cir. 2001).

²³⁶ See generally *Gibson*, 308 B.R. 763.

²³⁷ See, e.g., Consent Order to Lift Stay and Offset, *In re Farmer*, No. 10-09353, (Bankr. E.D.N.C. Mar. 30, 2012).

²³⁸ See *id.*; *In re Farmer*, No. 10-09353, 2012 WL 4905480, at *2 (Bankr. E.D.N.C. Oct. 15, 2012); *In re VanderHouwen*, No. 03-01244, 2010 Bankr. LEXIS 156, at *9 (Bankr. E.D. Wash. Jan. 15, 2010).

²³⁹ See, e.g., *Farmer*, 2012 WL 4905480, at *2; *VanderHouwen*, 2010 Bankr. LEXIS 156.

²⁴⁰ See 11 U.S.C. § 541(a) (2012).

postpetition application, and when both the legislation and the filing of the application occur postpetition.

A. *Prepetition Legislation and Postpetition Application Date*

The two SURE cases in this factual bucket each deal with § 553 and the right of setoff. The first case was decided easily, and a setoff was granted.²⁴¹ In the second case, the parties reached a settlement on one issue.²⁴² On the second issue, the court found the statutory authorization date to be determinative of when a government payment is “absolutely owed,” yet interestingly still engaged in a factual inquiry.²⁴³

In the first case, *In re Smith*, the debtor owed the USDA \$66,142.²⁴⁴ On November 19, 2011, the debtor filed for bankruptcy, and shortly thereafter filed an application for a SURE payment due to the destruction of his 2010 crop.²⁴⁵ On April 3, 2012, the USDA filed a Motion for Offset. The government’s Motion to Lift the Stay asserted that although the application for the SURE payment was not filed until after the debtor filed for bankruptcy, the debt arose prior to bankruptcy and the USDA possessed the right to offset.²⁴⁶ On June 4, 2012, the Court granted the USDA’s motion to lift the automatic stay, which allowed the offset of the SURE payment.²⁴⁷

The second case, *In re Farmer*, is similar to *Smith* because the authorizing legislation was signed prepetition, but the debtor filed a SURE application postpetition.²⁴⁸ In *Farmer* the debtor filed for chapter 12 on November 11, 2010.²⁴⁹ On November 30, 2010, the USDA designated forty-two North Carolina counties as a Primary Natural Disaster Areas, including the county where the debtor resides.²⁵⁰ In 2011, the debtor filed a SURE application due to the destruction of his 2010 crop, and received a payment of \$53,316.²⁵¹ On

²⁴¹ Order for Offset, *In re Smith*, No. 11-08865 (Bankr. E.D.N.C. June 4, 2012).

²⁴² Motion to Lift Stay and for Offset, *In re Farmer*, No. 10-09353 (Bankr. E.D.N.C. Feb. 29, 2012).

²⁴³ *In re Farmer*, No. 10-09353, 2012 WL 4905480, at *2 (Bankr. E.D.N.C. Oct. 15, 2012).

²⁴⁴ Motion for Offset at 1, *In re Smith*, No. 11-08865 (Bankr. E.D.N.C. Apr. 3, 2012).

²⁴⁵ *Id.*

²⁴⁶ *Id.* at 2.

²⁴⁷ Order for Offset, *In re Smith*, No. 11-08865 (Bankr. E.D.N.C. June 4, 2012).

²⁴⁸ See Motion to Lift Stay and for Offset at 1–2, *In re Farmer*, No. 10-09353 (Bankr. E.D.N.C. Feb. 29, 2012).

²⁴⁹ See *id.* at 1.

²⁵⁰ News Release, *supra* note 8; see Motion to Lift Stay and for Offset at 2, *Farmer*, No. 10-09353.

²⁵¹ Motion to Lift Stay and for Offset at 2, *Farmer*, No. 10-09353.

February 29, 2012, the USDA filed a motion for offset.²⁵² The debtor objected, stating the USDA “sought to offset a [postpetition] claim of the [d]ebtor against [the USDA’s prepetition] claim.”²⁵³ Rather than go to trial, the parties agreed to settle.²⁵⁴ Under the settlement, \$30,000 was offset by the USDA and the debtor received \$23,316.00.²⁵⁵

After settling the SURE payment, the parties then turned to the status of certain Direct and Countercyclical Program (DCP) payments.²⁵⁶ On May 31, 2012, the debtor applied to participate in the DCP for the 2012 crop year.²⁵⁷ USDA determined the debtor was entitled to \$7,255, and filed a motion to lift the automatic stay in order to offset.²⁵⁸ The court held a hearing on the issue of whether the 2012 DCP payments arose prepetition or postpetition.²⁵⁹ The USDA asserted that the DCP program began in 2002 and was continued in 2008 through passage of the Farm Bill, which provided funding through the 2012 crop year.²⁶⁰

The court held that the debtor “became eligible for DCP funds in 2008 with the passage of the 2008 Farm Bill.”²⁶¹ The court reasoned that at that point the USDA became obligated to pay farmers eligible for DCP through 2012.²⁶² Therefore, the statutory authorization date was determinative of when the payment became absolutely owed.²⁶³ Interestingly, the debtor’s land was a mix of owned and leased property.²⁶⁴ The court concluded the payments as to the owned land arose prepetition, but those as to the leased land arose postpetition.²⁶⁵ When the debtor filed for bankruptcy in 2010, it was not certain that he would have control over this land in 2012.²⁶⁶ A condition necessary for payment, the debtor’s control, occurred postpetition.²⁶⁷

²⁵² *Id.* at 1.

²⁵³ Objection to Motion to Lift Stay and for Offset at 1, *In re Farmer*, No. 10-09353 (Bankr. E.D.N.C. Mar. 12, 2012).

²⁵⁴ Consent Order to Lift Stay and Offset, *In re Farmer*, No. 10-09353 (Bankr. E.D.N.C. Mar. 30, 2012).

²⁵⁵ *Id.* at 2.

²⁵⁶ *See In re Farmer*, No. 10-09353, 2012 WL 4905480, at *1 (Bankr. E.D.N.C. Oct. 15, 2012).

²⁵⁷ *Id.*

²⁵⁸ *Id.*

²⁵⁹ *Id.*

²⁶⁰ *Id.*

²⁶¹ *Id.* at *2.

²⁶² *Id.*

²⁶³ *See id.* at *1–2.

²⁶⁴ *Id.* at *2.

²⁶⁵ *Id.* at *1.

²⁶⁶ *Id.*

²⁶⁷ *Id.* at *2.

These cases further the idea that a clearer standard guides analysis under § 553 than § 541, which necessitates a factual inquiry. However, even in the § 553 context, courts are beginning to regard the statutory authorization date as determinative to “absolutely owing” analysis, post- *Vote*, *Burgess*, and *Bracewell*. In *Farmer*, the parties reached a settlement as to the SURE payment. Although the precise reason is uncertain, a searching factual inquiry reveals agency discretion over a condition necessary for payment, a novel issue unaddressed by bankruptcy courts.

B. Postpetition Legislation and Postpetition Application Date

The two cases in this factual bucket each present the issue of whether a government assistance payment is property of the estate under § 541, post-*Vote*, *Burgess*, and *Bracewell*. The first case, *In re Andrews*, did not deal with a crop disaster payment program but with an economic stimulus payment.²⁶⁸ In *Andrews*, the debtor filed for bankruptcy on June 28, 2007.²⁶⁹ On February 13, 2008, the Economic Stimulus Act was signed into law, and the debtor immediately became eligible for a payment of \$1,200.²⁷⁰ To determine whether the stimulus payment was property of the estate, the court began its analysis by noting that the scope of § 541(a)(1) is broad and includes novel or contingent property interests.²⁷¹ However, the court cautioned that a broad judicial construction of § 541(a)(1) must also be constrained by the plain language of the statute, and only reach legal interests that existed as of the commencement of the case.²⁷²

The court acknowledged that similar to *Vote*'s crop disaster payments, the economic stimulus payment was not property of the estate because the federal legislation authorizing the payment was not enacted prior to the bankruptcy filing.²⁷³ The court reasoned that if a debtor has no means of knowing he qualifies for a government payment, no legal right can conceptually or actually exist.²⁷⁴ The court explained that “the inquiry is best determined by treating the

²⁶⁸ *In re Andrews*, 386 B.R. 871, 872 (Bankr. D. Utah 2008); Schneider, *supra* note 187.

²⁶⁹ *Andrews*, 386 B.R. at 872.

²⁷⁰ *Id.* at 872–73.

²⁷¹ *Id.* at 873 (citing *In re Montgomery*, 224 F.3d 1193, 1194 (10th Cir. 2000) (quoting *Barowsky v. Serelson*, 946 F.2d 1516, 1518–19 (10th Cir. 1991))).

²⁷² *Id.* (quoting *Drewes v. Vote (In re Vote)*, 261 B.R. 439, 442 (B.A.P. 8th Cir. 2001)).

²⁷³ *Id.* at 874.

²⁷⁴ *Id.*

date of petition as the deciding factor and applying the analysis of *In re Vote*.²⁷⁵

Another case worth noting is *In re VanderHouwen*, in which the legislation and the application were both passed postpetition.²⁷⁶ The court found that “[c]ircuit cases on the issue agree that the date of enactment of the crop disaster program is determinative as to whether the [government payment] is property of the bankruptcy estate.”²⁷⁷ Following this rule, the court held that the postpetition payment was not property of the estate.²⁷⁸ This reasoning strongly suggests that the date of legislation is determinative and therefore provides a bright line rule when engaging in § 541 analysis.²⁷⁹

These cases suggest that courts are beginning to regard the statutory authorization date as determinative in § 541 analysis. This result is inconsistent with the language of § 541, and indicates the need for a clear rule to determine when a government payment becomes property of the estate.²⁸⁰

V. ENFORCEABLE STANDARDS UNDER ADMINISTRATIVE LAW

In administrative law, the question of when a government payment becomes a “property interest” is relevant in the context of Fifth Amendment due process issues.²⁸¹ The due process right provided in the Fifth Amendment protects individuals only from deprivations of life, liberty, and property.²⁸² Once an individual has a recognized property interest under the Fifth Amendment, that individual cannot be deprived of this interest without due process of law prior to the deprivation.²⁸³ In the 1970s, the Supreme Court formulated a clear rule as to when a government payment becomes a property interest for purposes of the Fifth Amendment.²⁸⁴ This rule could be applied in

²⁷⁵ *Id.*

²⁷⁶ See *In re VanderHouwen*, No. 03-01244, 2010 Bankr. LEXIS 156, at *8–9 (Bankr. E.D. Wash. Jan. 15, 2010).

²⁷⁷ *Id.*

²⁷⁸ *Id.* at *9.

²⁷⁹ *Id.*

²⁸⁰ See *In re Farmer*, No. 10-09353, 2012 WL 4905480 (Bankr. E.D.N.C. Oct. 15, 2012); *VanderHouwen*, 2010 Bankr. LEXIS 156.

²⁸¹ See generally *Bd. of Regents of State Colls. v. Roth*, 408 U.S. 564 (1972); *Perry v. Sindermann*, 408 U.S. 593 (1972).

²⁸² See U.S. CONST. amend. V.

²⁸³ See *Roth*, 408 U.S. at 570–71 (stating that the court must determine whether the benefit at stake is a property or liberty interest before due process of law is required); *Perry*, 408 U.S. at 599 (stating that there is no due process requirement unless a property or liberty interest is implicated).

²⁸⁴ See generally *Roth*, 408 U.S. 564; *Perry*, 408 U.S. 593.

the bankruptcy context to provide clear guidance on when a debtor obtains a legal or equitable interest in a government payment when agency discretion is an issue.

The first case the Supreme Court decided was *Board of Regents of State Colleges v. Roth*. The plaintiff in *Roth* was an untenured professor at a public university who was informed, without explanation, that his contract would not be renewed the following year.²⁸⁵ The professor sued, claiming that the failure to provide him with notice and a hearing constituted a violation of his due process rights.²⁸⁶ The Supreme Court found that Roth's due process rights were not violated because he did not have a property interest in his contract for employment.²⁸⁷ The Court reasoned that "[t]o have a property interest in a benefit, a person clearly must have more than an abstract need or desire for it . . . [and] more than a unilateral expectation of it."²⁸⁸ Rather, a person needs "a legitimate claim of entitlement to [that benefit]."²⁸⁹ In this case, the express terms of the plaintiff's annual contract created no possible claim of entitlement to re-employment.²⁹⁰

Perry v. Sindermann, which was decided on the same day as *Roth*, also involved a claim by an untenured public university professor who lost his job following a short-term contract.²⁹¹ In contrast to *Roth*, the court in *Perry* found that the professor did have a property interest in his employment.²⁹² Unlike the employer in *Roth*, the employer in *Perry* had produced guidelines, handbooks and other official publications that may have created a "de-facto" tenure system.²⁹³ One faculty guideline provided that "[t]he Administration of the College wishes the faculty member to feel that he has permanent tenure as long as his teaching services are satisfactory."²⁹⁴ Because of the plaintiff's reliance on this language, he may have had a due process right that demanded his continued employment.²⁹⁵ Therefore, refusing to renew the professor's contract

²⁸⁵ *Roth*, 408 U.S. at 566, 569.

²⁸⁶ *Id.* at 566.

²⁸⁷ *Id.* at 568.

²⁸⁸ *Id.* at 577.

²⁸⁹ *Id.*

²⁹⁰ *Id.* at 575.

²⁹¹ *Perry v. Sindermann*, 408 U.S. 593, 594 (1972).

²⁹² *Id.* at 602–03.

²⁹³ *Id.* at 599–602.

²⁹⁴ *Id.* at 600.

²⁹⁵ *See id.* at 600–01.

with no explanation may have constituted a violation of his due process rights.²⁹⁶

The reason the Supreme Court found that a property right may exist in *Perry*, but not in *Roth*, was the existence of guidelines or standards.²⁹⁷ Without such guidelines, the government entity was not bound to act in a certain way.²⁹⁸ However, if guidelines were articulated, a “de facto” system may be found, creating an expectation and property right.²⁹⁹

VI. ANALYSIS

Recent holdings run contrary to both the Code and relevant case law because these cases state or imply that the statutory authorization date is determinative of when a debtor obtains a legal interest in a government payment.³⁰⁰ This is not the correct approach because the statutory authorization date is not necessarily the same as the date a debtor acquires a legal interest in a government payment as required by § 541(a)(1). Although the *Vote*, *Burgess*, and *Bracewell* decisions state that government payments authorized by postpetition legislation are not property of the estate, they do not go so far as to say that this is determinative in § 541 analysis. In the context of setoff, § 553 requires each debt to have arisen prepetition. Case law has formulated a clearer rule to determine when a government payment arose, articulated as when the payment is “absolutely owed.” Despite this clear rule recent cases also indicate confusion as to the effect of *Vote*, *Burgess*, and *Bracewell* in the § 553 context, and the importance attached the statutory authorization date.

This Comment proposes that the standard under both provisions should be when a government payment is “absolutely owed.”³⁰¹ A payment becomes “absolutely owing” when all of the conditions required for payment are satisfied, emphasizing the factual inquiry required under both §§ 541 and 553.³⁰² When a condition necessary for payment is dependent upon an act

²⁹⁶ *Id.* at 599.

²⁹⁷ Compare Board of Regents of State Colls. v. Roth, 408 U.S. 564 (1972), with *Perry*, 408 U.S. 593.

²⁹⁸ See generally *Roth*, 408 U.S. 564; *Perry*, 408 U.S. 593.

²⁹⁹ See generally *Roth*, 408 U.S. 564; *Perry*, 408 U.S. 593.

³⁰⁰ Compare 11 U.S.C. §§ 541(a), 553 (2012), with *In re Farmer*, No. 10-09353, 2012 WL 4905480 (Bankr. E.D.N.C. Oct. 15, 2012); *In re VanderHouwen*, No. 03-01244, 2010 Bankr. LEXIS 156 (Bankr. E.D. Wash. Jan. 15, 2010).

³⁰¹ See *Traders Bank of Kan. City v. Stonitsch (In re Isis Foods, Inc.)*, 24 B.R. 75, 76 (Bankr. W.D. Mo. 1982).

³⁰² See *In re Gibson*, 308 B.R. 763, 767–68 (Bankr. N.D. Tex. 2002).

within an agency’s discretion, analysis should be guided by administrative law. Analysis in this situation would turn on whether the agency has created guidelines or standards that create the kind of legitimate expectations discussed in *Regency* and *Roth*.³⁰³ When such guidelines exist, agency discretion is limited accordingly.³⁰⁴ Adopting this clear standard will limit arguments that a debtor obtains a legal right to a government payment at an alternative point in time, and clear up the law post- *Vote*, *Burgess*, and *Bracewell*.

Reproduced below is a table of the discussed case law, and which factual “bucket” each case falls into:

	Legislation Date	
	Prepetition	Postpetition
Application Date	Prepetition	<p>Gerth Mattice Schneider Matthieson</p>
	Postpetition	<p>Segal Ring Lesmeister Boyett Gibson <i>Smith</i> <i>Farmer</i></p> <p>Lemos Vote Burgess Bracewell <i>Andrews</i> <i>VanderHouwen</i></p>

The cases in italics are the recent cases. The cases in bold are those that discuss the right to setoff under § 553. The cases in plain text are those that deal with § 541 property of the estate analysis. The table is useful because it highlights the factual differences that have in part led to inconsistent holdings as to when a debtor obtains a legal interest in a government payment.

A. *Prepetition Legislation and Prepetition Application Date*

In the context of prepetition legislation and a prepetition application date, debtors often argue that they do not have a legal interest in a government payment until the application approval date, or some other point in time

³⁰³ See *supra* text accompanying notes 282296.

³⁰⁴ See *Perry*, 408 U.S. at 598–99.

postpetition.³⁰⁵ In cases dealing with property of the estate analysis under § 541, such as *Mattice* and *Schneider*, courts have held that a debtor does not hold an interest in a government payment until the application is approved.³⁰⁶ However, the government payments at issue in *Mattice* and *Schneider* were contractual in nature.³⁰⁷ Until each party approves the contract, a legal right or interest in a government payment could not exist; and in the case of a declaration, a regulation mandated approval of the contract by each party.³⁰⁸

In contrast, *Gerth* and *Matthieson*, which fall in the same factual bucket, deal with the right to setoff under § 553.³⁰⁹ In *Matthieson*, factually similar to *Mattice* and *Schneider*, the debtor argued he did not have a legal interest in the government payment until the application was approved.³¹⁰ In *Matthieson*, however, this argument failed because the government payment program at issue was an assistance program, and mutual duties were not required to be exchanged.³¹¹ Therefore, agreement or application approval was not a condition precedent to eligibility for payment.³¹² In *Matthieson*, the debtor met all of the conditions for payment *prior* to the application date, making the payment “absolutely owing.”³¹³ In *Gerth*, however, the program was contractual in nature.³¹⁴ The court rejected the debtor’s argument that he did not obtain a legal right to the payment until funds were distributed, and held that the debtor’s performance was not a “transaction necessary” to the farmer being entitled to payment, since the parties had already exchanged mutual promises, including the government’s promise to pay.³¹⁵

Case law shows that the distinction between contractual programs and assistance programs is an important threshold consideration. In the government payment context, an initial determination should be made as to whether the program is contractual in nature or purely a form of subsidy or assistance. An assistance program does not require as a condition precedent a mutual agreement because the payment is “absolutely owing” once the eligible debtor

³⁰⁵ See, e.g., *Moratzka v. Agric. Stabilization & Conservation Serv.* (*In re Matthieson*) 63 B.R. 56, 58 (D. Minn. 1986); *In re Mattice*, 81 B.R. 504, 506 (Bankr. S.D. Iowa 1987).

³⁰⁶ See *Schneider v. Nazar* (*In re Schneider*), 864 F.2d 683, 686 (10th Cir. 1988); *Mattice*, 81 B.R. at 506.

³⁰⁷ See *Schneider*, 864 F.2d at 685; *Mattice*, 81 B.R. at 506.

³⁰⁸ See *Schneider*, 864 F.2d at 685–86.

³⁰⁹ See *United States v. Gerth*, 991 F.2d 1428, 1429 (8th Cir. 1993); *Matthieson*, 63 B.R. at 58.

³¹⁰ See *Matthieson*, 63 B.R. at 58.

³¹¹ *Id.* at 58–60.

³¹² *Id.* at 60.

³¹³ See *id.*

³¹⁴ See *Gerth*, 991 F.2d 1433.

³¹⁵ See *id.* 1434–35.

satisfies all of the program requirements. The proposed rule is applicable in both of these contexts because, in a contractual program, an event necessary for a payment to become “absolutely owed” is mutual ratification. In an assistance program, the debtor needs to meet certain requirements, but no agency approval or actions serve as a condition precedent for eligibility.

B. Prepetition Legislation and Postpetition Application Date

The second factual bucket deals with cases where the legislation is passed prepetition but the debtor does not file an application until after the petition date. The rule that emerges from cases discussing property of the estate under § 541 in this factual category, is that a debtor obtains a legal interest in a government payment when all events giving rise to the benefit occur prepetition.³¹⁶ Although the reasoning behind the rule can be different, from *Ring*'s reliance on the definition of proceeds in the UCC, to *Boyett*'s focus on the language of § 541(a)(1) and (6), the overall purpose appears to be the same.³¹⁷ For example, in *Lesmeister*, the court found that the debtor had a legal interest in the government payment at issue at the time of the bankruptcy petition because all transactions necessary to payment had already occurred.³¹⁸ The debtor's argument that he had no such interest failed because the regulation's promulgation was not a transaction *necessary* for the debtor to become entitled to payment.³¹⁹

Similar to the previous factual bucket, these cases do not set a specific moment in time when the debtor obtains a legal or equitable interest in a government payment. However, the court in *Boyett* explicitly rejects the program application date as a qualifying event determinative to § 541(a) analysis in the context of assistance programs.³²⁰ The applicability of *Segal* and its “so rooted” test is barely addressed,³²¹ but it appears that the cases in this factual bucket would almost always satisfy such an approach. If the legislation was passed prepetition and the crop was lost prepetition, the events

³¹⁶ See *Boyett v. Moore (In re Boyett)*, 250 B.R. 817, 822 (Bankr. S.D. Ga. 2000); *Drewes v. Lesmeister (In re Lesmeister)*, 242 B.R. 920, 926 (Bankr. D.N.D. 1999).

³¹⁷ See *Boyett*, 250 B.R. at 822; cf. *Kelley v. Ring (In re Ring)*, 169 B.R. 73, 77 (Bankr. M.D. Ga. 1993) (holding that crop disaster payments were proceeds from prepetition crops). “Proceeds” is not defined by the Code, leading some courts to use the UCC definition to help guide analysis. See *id.* The UCC, however, is not dispositive in interpreting the statutory language of the Code. *Id.*

³¹⁸ *Lesmeister*, 242 B.R. at 926.

³¹⁹ *Id.* at 925–26.

³²⁰ *Boyett*, 250 B.R. at 822.

³²¹ See generally *id.* at 821; *Lesmeister*, 242 B.R. 920.

seem “so rooted” in the prebankruptcy past so as to constitute property of the bankruptcy estate.³²²

The only case discussing § 553 in this factual bucket is *Gibson*, which holds that a debt arises prepetition when the debt is “absolutely owing” on the petition date.³²³ Although the application was filed postpetition, applying for a payment does not, without more, make the government’s liability for the payment a postpetition debt.³²⁴ Rather, a debt is “absolutely owed” when the debtors satisfy all requirements for obtaining payment under the government program.³²⁵ *Gibson* appears to indicate that the § 553 analysis has a clearer rule than § 541(a) analysis.³²⁶

Using the “absolutely owed” *Gibson* rule in the § 541(a) context may help place emphasis on the necessary factual inquiry. Under both §§ 541 and 553, a debtor obtains a legal interest in a government payment when all requirements necessary for payment are satisfied. For example, under SURE, a debtor is entitled to payment when he possesses insurance, experiences a qualifying loss, and the county he resides in is designated a primary disaster area.³²⁷ All requirements will be satisfied and the payment will be absolutely owed when these conditions are satisfied. This fact-intensive approach should produce more consistent results, in line with the language and temporal limitations of the Code.³²⁸

C. Postpetition Legislation and Postpetition Application Date

Case law in the postpetition legislation and postpetition application fact pattern varies greatly, largely hinging upon whether a court believes *Segal*’s “so rooted” test survived passage of the Code.³²⁹ Early cases such as *Lemos* found the purpose-based approach of *Segal* to apply and control analysis.³³⁰ In *Lemos*, the court held that the government payments at issue resulted from

³²² See *Segal v. Rochelle*, 382 U.S. 375, 380 (1966).

³²³ See *In re Gibson*, 308 B.R. 763, 767–68 (Bankr. N.D. Tex. 2002).

³²⁴ *Id.* at 769.

³²⁵ *Id.* at 769–70.

³²⁶ Compare *id.* at 766–69, with *Lesmeister*, 242 B.R. at 923–26.

³²⁷ See U.S. DEP’T OF AGRIC., *supra* note 8.

³²⁸ See generally 11 U.S.C. §§ 541(a), 553 (2012).

³²⁹ Compare *Lemos v. Rakozy (In re Lemos)*, 243 B.R. 96, 100 (Bankr. D. Idaho 1999) (using the “so rooted” test), *abrogated by In re Stallings*, 290 B.R. 777, 781–82 (Bankr. D. Idaho 2003), with *Drewes v. Vote (In re Vote)*, 276 F.3d 1024, 1026–27 (8th Cir. 2002) (declining to use *Segal*’s “so rooted” where debtor had a “mere hope” to obtain relief).

³³⁰ See *Lemos*, 243 B.R. at 99–100.

activities and events “so rooted” in the prebankruptcy past that they constituted a legal interest under § 541(a)(1).³³¹ Although the authorizing legislation had not been passed at the time of the bankruptcy petition, the debtor had a contingent interest in the prospect of a federal program being adopted by Congress.³³² This is in stark contrast to the decisions in *Vote*, *Burgess*, and *Bracewell*.³³³ Taking a literal approach to § 541(a)(1)’s temporal limitation, those courts held that a debtor could not have a legal interest in a government payment that was not yet authorized by statute at the time of the bankruptcy petition.³³⁴ Such a prospect was a mere expectancy, and did not constitute a contingent interest.³³⁵

Bracewell and *Burgess* featured divided courts, with vocal dissents. The majority in each case rejected *Segal*’s “so rooted” test, strongly supporting *Vote*’s position that § 541(a)(1)’s temporal limitation controlled the analysis.³³⁶ The dissents, however, viewed § 541(a)(1) differently, noting its broad language was intended to bring within property of the estate contingent and unmatured claims.³³⁷ Furthermore, they found the Code and its legislative history to support survival of *Segal*’s purpose-based approach.³³⁸ The dissent reasoned that if the crop was lost prepetition, then a crop disaster payment authorized by postpetition legislation could still be property of the estate, since the events giving rise to the payment were “so rooted” in the prebankruptcy past.³³⁹

The pre-Code practices doctrine is a statutory interpretation principle stating, “pre-Code practices continue to be valid, unless Congress evinced clear intent to depart from them under the Code.”³⁴⁰ Due to this practice, unless *Segal* and its “so-rooted” test is expressly rejected, the case has survived passage of the Code and is still valid law. The legislative history of the Code states that “[t]he result in *Segal v. Rochelle* is followed, and the right to a

³³¹ *Id.*

³³² *Id.* at 99.

³³³ Compare *id.* at 100 (using the “so rooted” test), with *Vote*, 276 F.3d at 1026–27.

³³⁴ *Vote*, 276 F.3d at 1026.

³³⁵ See *id.* at 1026–27.

³³⁶ *Bracewell v. Kelley (In re Bracewell)*, 454 F.3d 1234, 1241–42 (11th Cir. 2006); *Burgess v. Sikes (In re Burgess)*, 438 F.3d 493, 498 (5th Cir. 2006).

³³⁷ See *Bracewell*, 454 F.3d at 1249–50; *Burgess*, 438 F.3d at 516–17.

³³⁸ See *Bracewell*, 454 F.3d at 1249; *Burgess*, 438 F.3d at 512.

³³⁹ See *Bracewell*, 454 F.3d at 1249; *Burgess*, 438 F.3d at 512.

³⁴⁰ Cf. Adam J. Levitin, *Toward a Federal Common Law of Bankruptcy: Judicial Lawmaking in a Statutory Regime*, 80 AM. BANKR. L.J. 1, at 57 (2006).

refund is property of the estate.”³⁴¹ The dissent and majority opinions in *Burgess* and *Bracewell* viewed the use of the word “refund” differently. The definition of refund in Black’s Law Dictionary is “[t]he return of money to a person who overpaid, such as a taxpayer who overestimated tax liability or whose employer withheld too much tax from earnings.”³⁴² This definition supports the proposition that Congress didn’t intend for *Segal* to apply to government payment programs generally, but rather wanted to limit its reach to cases involving refunds for overpayment.

The legislative history, however, maintains that “[t]he result of *Segal v. Rochelle* is . . . followed.”³⁴³ The phrase which follows, “and the right to a refund is property of the estate,” seems explanatory, rather than limiting, in nature.³⁴⁴ *Segal* created a very broad “so rooted” test, which, if expressly followed would reach beyond the narrow tax refund context.³⁴⁵ The Supreme Court, however, denied a petition for certiorari in *Bracewell*, lending some credence to its central holding that a government payment authorized by postpetition legislation is not property of the estate.³⁴⁶ This may be because the majority reached the correct result in the case even though they were wrong in finding *Segal* did not survive passage of the Code. Under the *Segal* test and § 541(a)(1)’s temporal limitation, a debtor cannot have a legal interest in a government payment not yet authorized by Congress on the date of the bankruptcy petition.³⁴⁷ Payment related to a non-existent program seems far from “rooted” in the prebankruptcy past.³⁴⁸

D. Recent Case Law and the Proposed Rule

The recent case law discussed indicates the need for a clear standard post-*Vote*, *Burgess*, and *Bracewell*. In *Farmer*, as to the SURE payment, the involved parties reached a settlement.³⁴⁹ The *Gibson* rule, however, should have resulted in an easy victory for the government. As to the DCP payment in

³⁴¹ H.R. REP. 95-595, at 367 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6323.

³⁴² BLACK’S LAW DICTIONARY 1394 (9th ed. 2009).

³⁴³ H.R. REP. 95-595, at 367.

³⁴⁴ *Id.*

³⁴⁵ See generally *Segal v. Rochelle*, 382 U.S. 375 (1966).

³⁴⁶ See *Bracewell v. Kelley* (*In re Bracewell*), 454 F.3d 1234, 1247 (11th Cir. 2006), cert denied, 549 U.S. 1301 (2007).

³⁴⁷ See *Segal*, 382 U.S. at 380–81.

³⁴⁸ *Contra id.* at 375.

³⁴⁹ Consent Order to Lift Stay and Offset at 1, *In re Farmer*, No. 10-09353 (Bankr. E.D.N.C. Mar. 30, 2012).

Farmer, the court found the statutory authorization date to be indicative of when USDA's obligation to the debtor arose.³⁵⁰ This was a strange result, especially when one considers the fact that the DCP payment was tied to the debtor's postpetition 2012 crop.³⁵¹ Finally, in *VanderHouwen*, the court held that "the date of enactment of the crop disaster program is *determinative* as to whether the [crop disaster payment] is property of the bankruptcy estate."³⁵² These holdings, which regard the statutory authorization date as determinative in §§ 541 and 553 analysis, run afoul of the Code and relevant case law.

The proposed rule, that a debtor obtains a legal right in a government payment when the payment is "absolutely owed," stresses the necessary factual inquiry under §§ 541 and 553, and limits alternative approaches. One such approach, which courts seem to be endorsing, is that a right to a government payment is created when the legislation authorizing the payment is passed.³⁵³ This argument, however, seems to contradict the Code because it would give debtors in certain cases a legal interest in government payments authorized by prepetition legislation, but tied to postpetition losses. This stretches the language of both §§ 541(a)(1) and 553.³⁵⁴ Under § 541(a)(1) how could the debtor possibly have a "legal or equitable interest" in a government payment as of the petition date when he has yet to experience a qualifying loss?

Such a reading would blatantly distort the provision's temporal limitation, and expand the bankruptcy estate's reach to all government payments authorized by prepetition legislation regardless of when the events necessary for payment occurred. Cases that apply this rule, such as *VanderHouwen*, misinterpret *Vote*, *Burgess*, and *Bracewell*.³⁵⁵ These cases did not find the statutory authorization date to be determinative, and only held that payments authorized by postpetition legislation were not property of the estate.³⁵⁶

A second alternative approach: that a debtor obtains a legal interest in a government payment only upon agency approval of the application, is based on cases like *Mattice* and *Schneider*. In *Mattice* and *Schneider*, the type of

³⁵⁰ *In re Farmer*, No. 10-09353, 2012 WL 4905480, at *1–2 (Bankr. E.D.N.C. Oct. 15, 2012).

³⁵¹ *See id.* at *1.

³⁵² *In re VanderHouwen*, No. 03-01244, 2010 WL 227679, at *8–9 (E.D. Wash. Jan. 15, 2010) (emphasis added).

³⁵³ *See id.*

³⁵⁴ *See generally* 11 U.S.C. §§ 541(a)(1), 553 (2012).

³⁵⁵ *See* *Bracewell v. Kelley* (*In re Bracewell*), 454 F.3d 1234, 1247 (11th Cir. 2006); *Burgess v. Sikes* (*In re Burgess*), 438 F.3d 493, 507–08 (5th Cir. 2006).

³⁵⁶ *Compare* *Bracewell*, 454 F.3d at 1247, and *Burgess*, 438 F.3d at 507–08, with *VanderHouwen*, 2010 WL 227679, at *8–9.

government payment program involved required continuing duties to be performed by both the debtor and the government.³⁵⁷ The courts in each case held that the debtor did not have an interest in the government payment until the application was approved by the administering agency.³⁵⁸ But in the context of creating a contract, approval and execution of an agreement is a condition necessary for eligibility. These cases are consistent with a rule that focuses upon when the payment becomes “absolutely owing” and all conditions required for payment are satisfied. It is important, however, to keep in mind that if the government program at issue is contractual, then approval is a necessary condition, and the debtor cannot obtain a legal interest in the payment until such approval is obtained.

The rule that a debtor obtains a legal interest in a government payment when the debt is “absolutely owing” and all requirements for payment are satisfied is preferable and is a more accurate interpretation of the Code than the alternative approaches. The factual inquiry required by this rule is compatible with § 541(a)(1)’s temporal limitation.³⁵⁹ It is also consistent with *Segal* and does away with the need to find *Segal* superseded by the passage of the Code, as the majority opinions in *Burgess* and *Bracewell* did.³⁶⁰

Another aspect of the “absolutely owing” rule that must be addressed is the effect of agency discretion on a condition necessary for payment. To help guide analysis of this issue, bankruptcy law should look for guidance in administrative law. Although administrative law is not dispositive when interpreting the statutory provisions of the Code, administrative law is a useful and effective guide.

In administrative law, for purposes of due process, an individual has a property right or interest when the agency creates guidelines or standards.³⁶¹ The two seminal cases of *Perry* and *Roth* illustrate this rule.³⁶² In *Roth*, the public university did and said nothing to give employees an expectation of

³⁵⁷ See *Schneider v. Nazar (In re Schneider)*, 864 F.2d 683, 685–86 (10th Cir. 1988); *In re Mattice*, 81 B.R. 504, 505–07 (Bankr. S.D. Iowa 1987) (duty to not plant crops in exchange for payment).

³⁵⁸ See *Schneider*, 864 F.2d at 685–86; *Mattice*, 81 B.R. at 505–07.

³⁵⁹ Cf. 11 U.S.C. § 541(a)(1).

³⁶⁰ See generally *Bracewell*, 454 F.3d at 1241–42; *Burgess*, 438 F.3d at 498.

³⁶¹ See *Board of Regents v. Roth*, 408 U.S. 564, 566–67 (1972); cf. *Perry v. Sindermann*, 408 U.S. 593, 602–03 (1972).

³⁶² See *Roth*, 408 U.S. at 566–67 (1972); cf. *Perry*, 408 U.S. at 602–03 (1972) (allowing plaintiff to attempt to prove that administrator’s discretion was cabined sufficiently to make his interest in continued employment a property interest).

continued employment.³⁶³ Contrastingly, the public university in *Perry* issued a handbook that led the professor to believe his employment would continue as long as his performance was satisfactory.³⁶⁴ The employee fired in *Perry* may have held a property interest because of these enforceable standards, while the employee in *Roth* did not.³⁶⁵ This “enforceable standards” rule can be applied in bankruptcy cases when a condition is subject to agency discretion. If there are standards guiding that discretion at the time of the bankruptcy petition, then the condition can be regarded as satisfied. If no such standards exist then the condition is subject to the agency’s pure unbridled discretion, rendering the condition unsatisfied and leaving the debtor with no legal interest at the time of the petition. Such a rule could provide useful guidance to bankruptcy courts considering whether government payments subject to agency discretion are property of the estate under § 541(a)(1), or subject to setoff under § 553.

E. Application to SURE

Applying the proposed framework to SURE demonstrates its efficacy, and resolves a number of the issues posed by the SURE program. The first step is to determine when a payment under SURE becomes “absolutely owing,” and all requirements necessary for payment are satisfied. In the context of SURE payments, all requirements are met in most cases when: (1) the farmer suffers the necessary crop loss; (2) the farmer possesses USDA crop insurance; and (3) the crop is located in a Secretarial Designated Disaster County.³⁶⁶ If all three requirements are met prepetition, then the payment is “absolutely owed” and is property of the bankruptcy estate under § 541, or can be subject to setoff under § 553. The third condition often takes months, and may occur postpetition, presenting a temporal issue.³⁶⁷ If the Secretary Disaster Designation does occur postpetition, analysis then turns to the administrative law framework, focusing on whether the USDA created enforceable standards to guide agency discretion.

³⁶³ See *Roth*, 408 U.S. at 566–67.

³⁶⁴ *Perry*, 408 U.S. at 600.

³⁶⁵ Compare *Roth*, 408 U.S. at 568 (explaining that there was no expectation for employee to assume that he had property right in his employment continuing), with *Perry*, 408 U.S. at 600–01 (showing that by providing employee guidelines and a handbook, employer created enforceable standards by which to follow if it wanted to release employee).

³⁶⁶ See U.S. DEP’T OF AGRIC., *supra* note 8.

³⁶⁷ See Motion to Lift Stay and for Offset at 2, *In re Farmer*, No. 10-09353 (Bankr. E.D.N.C. Feb. 29, 2012); *News Release*, *supra* note 10.

The SURE program's statutory and regulatory language provides the Secretary of Agriculture with little guidance as to when to designate a county as a Secretarial Designated Disaster County.³⁶⁸ The regulations are so subjective that they do not seem to create an expectation that a designation will be granted.³⁶⁹ Although the new regulations provide for automatic designation when certain drought levels are reached, discretion remains in a large number of other cases.³⁷⁰ This discretion with no enforceable guidelines or standards means that when a disaster designation is made postpetition, a SURE payment would not be property of the estate under § 541, or subject to setoff under § 553.³⁷¹ This matters a great deal to creditors, who would not be entitled to distribution of these funds. The overall effect may seem harsh to creditors, but the proposed framework is effective, clear, and is the most accurate interpretation of the Code.

CONCLUSION

This Comment has argued that a government payment becomes property of the estate when a government payment is (1) "absolutely owed" and (2) enforceable standards limit agency discretion. Recent case law has regarded the date the authorizing legislation was signed into law as determinative of when a debtor obtains a legal interest in a government payment. This approach misinterprets case law and the language of §§ 541 and 553. The proper standard should focus on when a government payment is "absolutely owed," and all requirements for payment are met. This standard emphasizes the necessary factual inquiry required by both provisions and can be applied to assistance- and contract-based government programs alike.

Furthermore, if a condition required for payment is subject to agency discretion on the date of the petition, administrative law should help guide the analysis. *Perry* and *Roth* indicate that for the purposes of due process, an individual obtains a property interest in a government payment when an agency creates enforceable guidelines or standards. If this framework is adopted going forward, it can help guide analysis and reduce litigation related to government payments under §§ 541 and 553. The proposed result may not be comprehensive, but it is a step in the right direction and should provide

³⁶⁸ See 7 C.F.R. § 1945.20 (2013).

³⁶⁹ See 7 C.F.R. § 1945.20 ("[T]he Secretary . . . [shall] consider whether a [disaster] determination should be made . . .").

³⁷⁰ See 7 C.F.R. § 759.

³⁷¹ See generally 11 U.S.C. §§ 541(a)(1), 553 (2012).

some clarity as to exactly when a debtor obtains a legal interest in a government payment.

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