
Thomas L. Weinberg

Abstract: In Rainier National Bank v. Bachmann, the Washington Supreme Court held that payments made to a debtor under the federal Dairy Termination Program were "proceeds" of the collateral at issue in the case under the Uniform Commercial Code ("UCC"). The author examines the relationship between proceeds and the collateral described by parties to a security agreement, concludes that the court improperly applied the UCC in Bachmann, and recommends an approach to evaluating proceeds.

A lender's security interest in collateral includes the proceeds received by the debtor upon disposition of the collateral under Uniform Commercial Code ("UCC") § 9-306.¹ The need for a security interest in "proceeds" of collateral stems from the danger that a secured lender may have no security if its interest in collateral is lost when the debtor sells or otherwise disposes of the collateral.² In a normal sale of collateral, the lender's security interest attaches to the proceeds of its sale. However, some transactions do not resemble a normal sale.

In Rainier National Bank v. Bachmann,³ the Washington Supreme Court considered whether payments made to dairy farmers by the federal government under the Dairy Termination Program ("DTP")⁴ were "proceeds" of the bank's security interest in a borrower's dairy cattle under Washington's version of UCC § 9-306(1).⁵ The court held, in a five-to-four decision, that the entire payment made to eliminate the farmers from the dairy business was proceeds of cattle, the collateral stated in the security agreement.

In unusual cases, such as Bachmann, the limits of what constitutes proceeds are not intuitive. A useful approach to the problem, however, can be gleaned from the purposes and policies of the UCC, and

¹. Proceeds are defined as "[w]hatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds." U.C.C. § 9-306(1) (1987).
². See id. §§ 9-306(2), 9-307, 9-308, 9-309. These sections provide that some purchasers take collateral free of a secured party's perfected security interest.
⁵. 111 Wash. 2d at 308, 757 P.2d at 985 (applying WASH. REV. CODE § 62A.9-306(1) (1987)). Although there is one difference between the official version of the Uniform Commercial Code ("UCC") and the version enacted in Washington, contained in § 9-306(3)(b), this difference is not important here. References to the UCC will hereinafter be to the 1972 revision of Article 9, contained in the 1987 Official Text of the UCC, except where noted.

761
from cases in which courts have struggled with the limits of proceeds. This analytical approach focuses on the collateral that parties contract to encumber through a security agreement, and the relationship of the collateral through its “disposition” to the money or goods received by the debtor and claimed by the secured party as proceeds.

Applied to the facts of *Bachmann*, this analysis reveals that the court went too far in granting Rainier Bank an interest in the entire DTP amount. The cattle were disposed of by the debtors in *Bachmann*, but their proceeds were not the entire DTP amount. Rather, the secured lender had an interest in the DTP payments as proceeds only to the extent the payments reflected the value of the cattle, the stated collateral in the security agreement. This conclusion would have better promoted the UCC’s purposes and policies of uniformity and expansion of commercial lending practices.

I. PROCEEDS UNDER ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE

A. Article 9 Security Interests and “Proceeds”

Article 9 of the UCC governs security interests in personal property. In a secured loan transaction, a debtor receives money and grants an interest in personal property to the creditor as collateral. Where the collateral remains in the debtor’s hands, a written security agreement must be signed by the borrower. The security agreement must reasonably identify the collateral encumbered.7

The UCC offers protection to creditors when debtors dispose of collateral. Creditors may follow collateral to its new owner if the debtor parts with it.8 The creditor also has a right to any proceeds received by the debtor upon disposition of the collateral.9 “Proceeds” are defined as “whatever is received upon the sale exchange, collection, or other disposition of collateral or proceeds.”10 They are typically the

6. U.C.C. § 9-203 (1987). Beyond the written security agreement, in order for a security interest to become enforceable against the debtor, or “attach,” the lender must have given “value” (e.g., loan money), and the debtor must have “rights in the collateral.” *Id.* §§ 9-203(2), 9-203(1)(a) & (b). One of the purposes of the security agreement is evidentiary. It “minimizes the possibility of future dispute . . . as to what property stands as collateral for the obligation secured.” *Id.* § 9-203 official comment 3.
7. *Id.* § 9-110.
8. *Id.* § 9-306(2).
9. *Id.*
10. *Id.* § 9-306(1). Generally, a right to the proceeds of collateral is presumed without the word “proceeds” appearing in the security agreement or financing statement. *Id.* *But see id.* § 9-306(3) (after ten days security interest in proceeds becomes unperfected in certain cases).
Proceeds Under UCC Article 9

money received when collateral is sold by a debtor. However, proceeds under section 9-306(1) may include items received other than cash, from transactions other than sales. For example, the UCC expressly provides that the definition of proceeds includes insurance payments made upon loss or damage to collateral.12

B. Judicial Rendering of “Other Disposition” and “Proceeds”

The limits of what may be an “other disposition” under UCC § 9-306(1) are broad. For example, courts have found court awards of “accounts and contract rights” and the cancellation of debt to be dispositions under section 9-306(1). Moreover, the proceeds of a disposition can come from more than one source. The return by the government of customs duties paid by an importer of goods upon the final export of a finished product was proceeds because the export itself was a disposition.15 Transportation costs forwarded by a company hired to ship strawberries were proceeds of the strawberries when transportation was a disposition of the collateral. In these cases, the source of proceeds was both the sale price of the collateral and the customs duties or forwarded transportation costs.

Courts have imposed limits, however, on what constitutes an “other disposition” and thus what constitutes proceeds under section 9-306(1). The connection between the original collateral and the proceeds claimed may be too distant for the amount to be considered a product of a “sale, exchange, collection or other disposition” of the collateral. In order to be proceeds, what is received must actually be a product of the disposition of the collateral, and not from some other

11. E.g., United States v. Handy and Harman, 750 F.2d 777, 785 (9th Cir. 1984) (accounts); Security Sav. Bank v. United States, 440 F. Supp. 444, 446 (S.D. Iowa 1977) (goods traded for the original collateral); Ford Motor Credit Co. v. Exchange Bank & Trust Co., 251 Ark. 881, 476 S.W.2d 208, 211 (1972) (chattel paper); see 2 G. Gilmore, SECURITY INTERESTS IN PERSONAL PROPERTY § 27.4, at 732–36 (1965). Furthermore, non-negotiable instruments or general intangibles may be proceeds. See id. at 735 n.4. Although Gilmore viewed the hypothetical appearance of non-negotiable instruments or general intangibles as proceeds as “unlikely,” id., they have been found to be proceeds. See e.g., Osteros v. Norwest Bank Minot, N.A., 604 F. Supp. 848, 849 (D.N.D. 1984) (general intangible); Webster City Prod. Credit Ass'n v. G.O. Implement, Inc., 310 N.W.2d 541, 542 (Iowa Ct. App. 1981) (non-negotiable document).
source. For example, the ingestion and digestion of grain by livestock was not a disposition of grain, so the livestock was not proceeds of the grain. The transfer of corporate ownership of equipment, when the corporations involved were owned by the same people, was also not a disposition under section 9-306(1). Simply because there has been action affecting the collateral does not mean that section 9-306 has been triggered. One must look closely at the transaction involved.

C. The Payment-in-Kind Program and Proceeds

Tension between a broad conception of proceeds that liberally construes "other disposition" in section 9-306(1) and a more limited conception of proceeds is seen in the numerous proceeds cases involving the payment-in-kind ("PIK") agricultural subsidy program. The PIK program, like many agricultural programs, was designed to limit the market supply of certain crops. In the program, a farmer agreed not to plant a crop or destroyed a growing crop, and received an in-kind payment of that crop in return. The farmer was then free to sell this in-kind payment through usual channels.
A majority of courts have found that PIK payments, if no crop was grown, were not proceeds of crops named as collateral in security agreements. Because there was no collateral to dispose of, no security interest attached to the PIK payments. These courts have reasoned that subsidy programs in agriculture have been in existence for many years, so lenders should describe their intended collateral completely if they desire an interest in PIK payments. Careful drafting is the proper solution for secured parties.

These decisions in cases in which no crops were grown imply that PIK payments are proceeds when crops have been grown, because the collateral described in the security agreement exists and is capable of being "disposed of." Some courts have explicitly made this crops-no crops distinction. Thus, in the PIK cases, courts have examined the collateral at issue, and its relation to the PIK payments claimed as proceeds.

D. The Dairy Termination Program and Proceeds

The Dairy Termination Program, like other agricultural subsidy programs, is intended to stabilize commodity prices and promote the livelihood of farmers. The goal of the DTP is to reduce the market supply of milk by permanently reducing the number of producers. In the program, dairy farmers receive payments based on the value of their milk production business, calculated by each farmer in a bid submitted to the Commodity Credit Corporation. After a bid is

24. *See, e.g., In re George*, 85 Bankr. 133, 144 (Bankr. D. Kan. 1988); *In re Clark*, 82 Bankr. 131, 133 (Bankr. D. Colo. 1987). Courts that have held PIK payments to be proceeds when no crop was grown have reasoned that they are a substitute for the crops that farmers would have grown if they never entered the program. *See, e.g., In re Cupp*, 38 Bankr. 953, 955 (Bankr. N.D. Ohio 1984); *Production Credit Ass'n of Fairmont v. Martin County Nat'l Bank of Fairmont*, 384 N.W.2d 529, 531–32 (Minn. Ct. App. 1986).

25. *Id.* at 684; *accord Marsh*, *supra* note 22, at 312.

26. *Id.* at 684; *accord Marsh*, *supra* note 22, at 312.


33. 7 C.F.R. § 1430.456 (1988). The bid equals the product of a proposed dollar amount per hundredweight of milk and the farmers' contract base. *Id.* The contract base is the quantity of milk marketed for commercial use during one of two twelve-month periods, subject to adjustments related to time of ownership of the cattle by producers participating in each bid. *Id.*
accepted, farmers receive DTP payments if they sell all their dairy cattle for slaughter or export from the United States, and agree to relinquish any ownership interest in dairy cattle or the production of milk for five years.

In the decisions handed down before Bachmann, courts found either that the DTP payments are not proceeds of cattle or are proceeds of non-cattle property. In these cases, the courts examined the language of each creditor's security agreement. Where the security agreements claimed “general intangibles” or “contract rights” as original collateral, the creditor received the entire DTP amount. However, where the parties did not agree to include the assets of the ongoing business or use language such as “general intangibles” or “contract rights,” the creditors could not reach the payments as proceeds of cattle. These cases demonstrate the importance of the relationship between what is claimed as original collateral in a security agreement and what is claimed to be proceeds of that collateral. For example,

§ 1430.455. If the bid is accepted, a contract is signed, id. § 1430.456(c), which entitles a participating producer to receive the amount of the bid by one of two payment schedules spread over five years. Id. § 1430.459(a), 1430.459(f). The money promised by the government cannot be paid until it is determined that the farmer has complied with the requirements of the program. Id. § 1430.459. In each of the five years of the DTP contract, farmers must certify to officials that they are complying by not owning dairy cattle or production facilities. Id. § 1430.459(g). There are penalties for non-compliance or fraud, including refund of the DTP payments. Id. § 1430.462.

34. Id. § 1430.457. Farmers must sell their cattle before the end of a period stated in their contract with the government. Id.

35. Id. § 1430.457(b).

36. In re Hofstee, 88 Bankr. 308, 310–11, modified by addendum at 312 (Bankr. E.D. Wash. 1988) (payments were proceeds of the debtors' business “goodwill,” a general intangible covered by the security agreement); FMB-First Mich. Bank v. Van Rhee, 681 F. Supp. 1264, 1268 (W.D. Mich. 1987) (payments were proceeds of “the specific property [including livestock], together with all related rights” (emphasis by court)); Lisbon Bank & Trust Co. v. Commodity Credit Corp., 679 F. Supp. 903, 905 (N.D. Iowa 1987) (payments were not proceeds of cattle); Bank of North Ark. v. Owens, 76 Bankr. 672, 674 (E.D. Ark. 1987) (payments were not proceeds of cattle); In re Grunzke, 68 Bankr. 446, 449 (Bankr. D. Minn. 1987) (payments were not proceeds of cattle); In re Weyland, 63 Bankr. 854, 858–59 (Bankr. E.D. Wis. 1986) (payments were not proceeds of cattle, but were “general intangibles”); see In re Collins, 68 Bankr. 242, 243 (Bankr. D. Minn. 1986) (issue whether payments were proceeds not reached because “general intangibles” described in the security agreement); see also In re Bowling, 64 Bankr. 710, 713 (Bankr. W.D. Mo. 1986) (a security interest in dairy cattle entitled creditor to lien on DTP payments up to market value of the cattle).

37. Van Rhee, 681 F. Supp. at 1267 (general intangibles); Lisbon, 679 F. Supp. at 906 (contract rights); Collins, 68 Bankr. at 243.

38. Owens, 76 Bankr. at 674; Weyland, 63 Bankr. at 859; see Van Rhee, 681 F. Supp. at 1268 (the language of the parties' security agreement encumbered the debtors' dairy business).

39. A noteworthy case applying this principle in detail is In re Hofstee, 88 Bankr. 308 (Bankr. E.D. Wash. 1988). Hofstee, a Washington bankruptcy case, was originally decided before Bachmann. In Hofstee, the debtors entered into a DTP contract after filing for bankruptcy. The
Proceeds Under UCC Article 9

in a case where the parties merely listed as collateral in their security agreement cattle, farm equipment, and all property which "result[ed]" from these items, the DTP payments were not the proceeds of anything that had been agreed upon as collateral. The DTP payments stemmed from an agreement to get out of the dairy business, something not contracted for as security. Similarly, other courts have found part of the payments to be proceeds of either the farmers' businesses or promises to get out of the dairy business.

On the other hand, several courts have implied that DTP payments may be proceeds of cattle to the extent they are compensation for cattle. These courts examined the components of the claimed proceeds amount, and gave the lender either the difference between slaughter value and market value, or the component of the DTP payments equalling the cattle's market value.

court was required to determine who had an interest in the payments in considering the debtors' reorganization plan that covered these payments. In the court's initial decision, it held that DTP payments were based primarily on the goodwill value of the debtors' business and the value of their personal covenant to forego their vocation. Therefore, the portion attributable to goodwill, a general intangible covered by the parties' security agreement, could be claimed as proceeds of the agreed collateral, but the portion related to the covenant could not.

After the Bachmann decision, the court revised its holding. In an addendum to the original opinion, it interpreted the decision to mean that the entire DTP amount was "proceeds" of the debtors' cattle. However, the court continued to hold that some of the DTP money had its source in the debtors' covenant to forego ownership in a dairy operation and was not the amount that would have been received by the creditor if the debtors had disposed of their cattle outside the program. The court based its stance on its equitable powers under bankruptcy law.

40. Owens, 76 Bankr. at 673.
41. Id. at 674.
42. Id.
46. Van Rhee, 681 F. Supp. at 1268; Grunzke, 68 Bankr. at 449. Of course, the lender also received the proceeds of the sale of the cattle for slaughter.
47. Hofstee, 88 Bankr. at 310, 312 (the creditor was entitled to the market value rather than the auction slaughter value of the cattle, and therefore the portion of the DTP payments attributable to the cattle's market value was property of the debtors' estate under Chapter 11 of the Bankruptcy Code); see 11 U.S.C. § 541(a) (1982 & Supp. IV 1986) (defining property of the estate).
II. RAINIER NATIONAL BANK V. BACHMANN

The Washington Supreme Court in *Bachmann* held that Rainier Bank had a security interest in DTP subsidy payments received by the Bachmanns, the bank’s debtors. The security agreement at issue granted the bank an interest in the Bachmanns’ dairy livestock, dairy equipment, and farm products, and “[a]ll proceeds and products of the foregoing.” The Bachmanns’ bid to enter the DTP program was accepted, and as required by the DTP, the Bachmanns sold all of their dairy cattle for slaughter. They received both the proceeds from the auction of the cattle and the right to payments from the government. Upon default by the debtors, the bank claimed an interest in both amounts, but the debtors assigned only the slaughter value of the cattle to the bank and attempted to assign the DTP payments to other creditors.

The issue in the *Bachmann* case was whether the bank had a security interest in the DTP payments as proceeds of cattle and their products. This required the court to determine whether there had been an “other disposition” of the bank’s collateral when the Bachmanns entered the DTP under the Washington version of the UCC. The *Bachmann* court, in a majority opinion by Justice Brachtenbach, found that the DTP payments were proceeds under section 9-306. The court began its analysis by stating that the definition of proceeds is to be construed liberally, noting that its analysis would be made in “the factual context presented.” According to the court, the statutory definition of proceeds is binding upon the parties.

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48. Rainier Nat'l Bank v. Bachmann, 111 Wash. 2d 298, 299, 757 P.2d 979, 980 (1988). The court reversed summary judgment granted by the trial court denying Rainier Bank's claim that the DTP payments were subject to its personal property security interests. *Id.*

49. *Id.* at 300, 757 P.2d at 980.

50. *Id.*, 757 P.2d at 981.

51. *Id.* at 301, 757 P.2d at 981.

52. *Id.* at 300, 757 P.2d at 981.

53. *Id.* at 301, 757 P.2d at 981.

54. *Id.* at 302, 757 P.2d at 982. The bank's arguments “focus[ed] solely on its security interest in the dairy cattle and their proceeds.” *Id.* Thus the court did not reach the issue whether the payments were “accounts,” the collateral listed in another of the bank’s security agreements with the Bachmanns, *id.* at 301, 757 P.2d at 981, nor did it examine whether “equipment” or “farm products” covered in the same security agreement as the cattle affected the bank’s interest in the DTP payments.


56. *Bachmann,* 111 Wash. 2d at 302, 757 P.2d at 981 (citing *In re Munger,* 495 F.2d 511, 513 (9th Cir. 1974) (“proceeds” should be given a “flexible and broad content”).

57. *Id.*, 757 P.2d at 981.
to a security agreement.\textsuperscript{58} The court found that an "other disposition" encompasses transactions other than sales,\textsuperscript{59} including situations where money is received from someone other than a buyer. The cattle, the bank's collateral, were disposed of when the farmer entered the DTP. Because proceeds are defined as "whatever is received" from a disposition of collateral,\textsuperscript{60} the bank's security interest extended to DTP payments.\textsuperscript{61}

The court characterized the entirety of the bank's security interests\textsuperscript{62} as involving the Bachmanns' total dairy operation. It concluded that the parties contemplated that more than just the individual cows would serve as collateral.\textsuperscript{63} The bank's interests therefore attached to the business as a whole, rather than to specific pieces of property. The security agreement at issue in the \textit{Bachmann} case included collateral that was the income source of the business, the dairy cattle.\textsuperscript{64} Entering the DTP compensated the Bachmanns for more than the cattle's slaughter value; it also compensated for the value of the ongoing milk-production business.\textsuperscript{65} As a result, the DTP payments, corresponding to predicted future business revenues, were proceeds of the collateral.\textsuperscript{66}

The court also considered the parties' intent, finding that the parties intended when they contracted that DTP payments would be "proceeds" of the collateral.\textsuperscript{67} After construing the words "other disposition" to include transactions other than sales, the court stated that if the parties intended proceeds to be solely money received from a sale of the collateral, their agreement would have expressly limited proceeds to those received from sale.\textsuperscript{68} The court assumed that agricultural security agreements are drafted with agricultural subsidy

\begin{itemize}
\item \textsuperscript{58} \textit{Id.}, 757 P.2d at 982.
\item \textsuperscript{59} \textit{Id.} at 303, 757 P.2d at 982.
\item \textsuperscript{60} \textit{Id.} at 302, 757 P.2d at 982.
\item \textsuperscript{61} \textit{Id.} at 308, 757 P.2d at 985.
\item \textsuperscript{62} Rainier Bank had three security agreements. The first agreement encumbered "[a]ll Accounts (rights to payment for goods sold or leased or for services rendered) of Borrower now existing or hereafter acquired" and "[a]ll proceeds of the foregoing." \textit{Id.} at 299, 757 P.2d at 980. The second security agreement was the one at issue in \textit{Bachmann}. \textit{See supra} note 54 and accompanying text. The third agreement covered beef cattle and proceeds. \textit{Bachmann}, 111 Wash. 2d at 299–300, 757 P.2d at 980.
\item \textsuperscript{63} \textit{Bachmann}, 111 Wash. 2d at 302, 757 P.2d at 981–82.
\item \textsuperscript{64} \textit{Id.}, 757 P.2d at 982.
\item \textsuperscript{65} \textit{Id.} at 303, 757 P.2d at 982.
\item \textsuperscript{66} \textit{Id.} at 305, 757 P.2d at 983 (citing \textit{In re} Cupp, 38 Bankr. 953, 956 (Bankr. N.D. Ohio 1984)).
\item \textsuperscript{67} \textit{Id.} at 302–03, 757 P.2d at 982.
\item \textsuperscript{68} \textit{Id.}
\end{itemize}
payments in mind.\textsuperscript{69} Thus the court found that the parties must have intended to include DTP payments as proceeds of the original collateral, and the entire DTP amount was proceeds of the cattle and their products.

The four dissenting justices, in an opinion by Justice Dore, argued that finding the DTP payments to be "proceeds" was inconsistent with UCC \textsuperscript{9} § 9-306(1) and with the DTP's purpose, and that the holding resulted in an unjustified windfall for the creditor bank.\textsuperscript{70} The dissenters pointed out that because the parties' security agreement did not explicitly mention any government subsidy programs as collateral, the court should examine the intent of the parties at the time they contracted to determine whether subsidies like the DTP were intended to be collateral. The dissenting justices found no evidence of such an intent.\textsuperscript{71} Thus the UCC statutory definitions did not provide that the payments were covered by the parties' security agreement, either as "proceeds" or as original collateral.\textsuperscript{72}

The dissenters further argued that allowing the bank to have an interest in the DTP payments would be unfair. First, this result leaves debtors without the resources to seek new employment, leaving little incentive for a debtor to stay out of the dairy business.\textsuperscript{73} Second, unlike the Bachmanns, the bank would not be required to return the money if the Bachmanns breached, because it would not be bound by the covenant between the Bachmanns and the government.\textsuperscript{74} Third, the dissenting justices argued that any losses suffered by the bank could have been avoided through careful drafting; the bank could have included "government subsidies," "general intangibles," or "contract rights" as part of its original collateral.\textsuperscript{75} The dissenters would therefore have limited the bank's security to the slaughter value of the cattle.

\begin{itemize}
  \item \textsuperscript{69} Id. at 303-04, 757 P.2d at 982 (citing \textit{In re Munger}, 495 F.2d 511, 513 (9th Cir. 1974) (parties contract "with an awareness of the importance of . . . federal subsidy payments to the realities of financing a farming operation").
  \item \textsuperscript{70} Id. at 308, 757 P.2d at 985 (Dore, J., dissenting).
  \item \textsuperscript{71} Id. at 310, 757 P.2d at 986.
  \item \textsuperscript{72} Id.
  \item \textsuperscript{73} Id. at 314, 757 P.2d at 988.
  \item \textsuperscript{74} Id.
  \item \textsuperscript{75} Id. at 314-15, 757 P.2d at 988.
\end{itemize}
III. "WHATEVER IS RECEIVED": EVALUATING COLLATERAL, ITS DISPOSITION, AND PROCEEDS

The facts of Bachmann presented the court with a difficult problem under the UCC. Because the disposition of the cattle netted their slaughter value and triggered payment of the subsidy, there were two amounts that might be claimed as proceeds of the cattle. These facts required the court to answer questions related to the meaning and the limits of section 9-306(1). First, what was the collateral? Second, was there a "disposition" of this collateral? Finally, if the collateral was "disposed of," what was received upon this "disposition" and are there limits to "whatever is received"?

In Bachmann, the majority misconstrued the breadth of the parties' security agreement, which led to a grant of proceeds exceeding Rainier Bank's security interest. It is true that "disposition" is broadly construed, and that after a disposition of collateral occurs, proceeds can be received from more than one source. The amount claimed as proceeds, however, must be related to the collateral described in the security agreement which is actually "disposed of," even in cases involving multiple sources of proceeds. The bank's security interest in the proceeds of its collateral should have been limited to the sum of the slaughter value of the cattle at auction and the portion of the DTP payments which bring the total proceeds to the market value of the Bachmanns' dairy cattle.

A. The Court's Analysis in Bachmann

1. The Security Agreement at Issue

The court improperly applied UCC § 9-306(1) because it mischaracterized the collateral described by the language of the security agreement at issue. Under UCC § 9-203(1)(a), a security agreement must reasonably identify the collateral. The specific language of Rainier Bank's security agreement with the Bachmanns identified livestock, equipment, and farm products as the collateral. Of the listed collateral, the court focused solely on the livestock. There was no

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76. See supra notes 13–16 and accompanying text.
77. See supra notes 13–20 and accompanying text.
78. U.C.C. § 9-203(1)(a) (1987); see id. § 9-110.
79. Bachmann, 111 Wash. 2d at 299–300, 757 P.2d at 980. The security agreement further designated the herd as collateral by specifically listing the cattle owned by the debtor. Id. at 300, 757 P.2d at 980.
80. Id. at 301, 757 P.2d at 981. Although the DTP contract also requires that farmers not sell their milk production facilities for the five years of the contract, these facilities are defined by
hint that the parties intended "livestock" to mean anything more than its common meaning.81

The court viewed "livestock" as the equivalent of the Bachmanns' business. The value of their business, however, included items of personal property not described by the language of the bank's security agreement.82 For example, the business's value may be enhanced by its "goodwill,"83 and its rights to performance of a contract other than accounts by another party. These items are included as "general intangibles" in Article 9.84 Rainier Bank did not list general intangibles in its security agreement, either by using Article 9's terms or by any other language. Therefore, the security agreement did not identify a security interest in the Bachmanns' dairy business. It only indicated that the livestock and other tangible items would be encumbered. There was no need to go beyond the language of the security agreement to characterize the collateral.85
2. *Analysis of the Parties’ Intent*

Despite the plainness of the security agreement at issue, the court went beyond its language and analyzed the “factual context” of the security agreement. The rationale for the court’s characterization of the collateral in *Bachmann* was that the parties intended “livestock” to mean more than just cattle. The court found that the bank’s multiple security agreements with the Bachmanns expressed an intent to encumber a herd that represented a continuing, repetitive income flow, the proceeds of which were DTP payments. However, examining the collateral and the circumstances of the agreement from the perspective of the parties at the time of contracting, the court incorrectly held that the parties contracted to encumber more than just the market value of the cattle.

First, the dairy farming context of the security agreement provided no clear evidence that the DTP payments were to be proceeds of the collateral. The court concluded that because the agreement was drafted in the agricultural arena, and government subsidies are prevalent in agriculture, the parties must have intended that all subsidies be “proceeds.” However, it is equally, if not more, likely that if the parties truly intended to include government subsidies as collateral, they would have said so explicitly in the security agreement.

Second, the realities of personal property security suggest that the proceeds of the cattle offered as security did not exceed the market value of the cattle. The parties knew when they contracted that if something happened to the bank’s collateral to cause the end of the Bachmanns’ business, the bank would not have been able to claim the business’ repetitive income flow as its security. For example, the Bachmanns could have chosen to sell their cattle in a move to another business or occupation. The Bachmanns could have filed for a Chapter 7 bankruptcy liquidation. Most likely, they could have simply defaulted on their loan. All of these possible events were foreseeable when the parties composed their agreements. In each of these cases, the bank’s security would have been limited to the market value of the

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87. *Id.*
88. *Id.* at 303–04, 757 P.2d at 982 (citing *In re Munger*, 495 F.2d 511, 513 (9th Cir. 1974)).
89. *In re Schmaling*, 783 F.2d 680, 684 (7th Cir. 1986); *In re Binning*, 45 Bankr. 9, 12–13 (Bankr. S.D. Ohio 1984).
dairy cattle. Similar risks exist for financiers of any business, and these lenders likewise can only count upon the market value of their debtors' personal property as "proceeds."

Third, the UCC structure, which allows other lenders to safely predict which collateral is encumbered, makes it unlikely that the parties intended their described collateral to be so broad as to encompass the entire DTP payment as proceeds. For example, before the decision in Bachmann, secured party A could have entered into a security agreement with a debtor, claiming a security interest in livestock. Secured party B, seeing only the cattle (and their proceeds) as collateral in A's security agreement, could have claimed a security interest in everything else the farmer owned, including general intangibles, accounts, and other assets of the debtor's ongoing business. Before Bachmann, secured party B would have assumed these creditors could coexist. Under the holding in Bachmann, the result would be a priority clash not anticipated at the time of contracting.

3. The Policies of the UCC and the DTP

The court improperly weighed the policies of the UCC and the DTP. These policies indicate that DTP payments are not the proceeds of "livestock."

The policy of the UCC of uniformity among jurisdictions would have been better served by a different result in Bachmann. By basing the outcome of the case on the "factual context" of the security agreement,

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90. Upon default, creditors have the choice of (1) taking the collateral, selling it, and imposing on the debtor liability for any deficiency, U.C.C. § 9-504 (1987); (2) "strictly foreclosing" by taking the collateral as satisfaction for the loan with no right to any deficiency, id. § 9-505(2); or (3) obtaining a judgment and execution on the debt, id. § 9-501(1). The security agreement at issue in Bachmann also covered equipment, and if it were sold or destroyed, the bank would be entitled to its proceeds as well.

91. See, e.g., In re Grunzke, 68 Bankr. 446, 447-48 (Bankr. D. Minn. 1987). In Grunzke, the creditor drafted a security agreement encompassing virtually all personal property attendant to a dairy operation, including equipment, farm products, and livestock, "GENERAL INTANGIBLES," and "ACCOUNTS, CONTRACT RIGHTS AND OTHER RIGHTS TO PAYMENT" (emphasis in original) Included under the latter heading were:

Each and every right of Debtor to the payment of money, whether such right to payment now exists or hereafter arises . . . under any contract or agreement . . . together with all other rights and interests . . . which Debtor may at any time have by law or agreement against any account debtor or any other obligor obligated to make any such payment . . .

Id. at 448.

92. See In re California Pump & Mfg. Co., 588 F.2d 717, 720 (9th Cir. 1978) (to depart from the collateral described by the parties would thwart the UCC's aim " 'to provide a single and unified structure within which the immense variety of present day financing transactions can go forward with less cost and greater certainty.' " (quoting U.C.C. § 9-101 official comment (1987))).

Proceeds Under UCC Article 9

ment, and not on the language in the security agreement, the court created the possibility of a less uniform application of section 9-306(1) to agricultural subsidy and other unusual proceeds cases. The evidence outside the security agreement provided no support for the conclusion that the parties intended more than livestock to serve as collateral, and yet the court used this evidence to support its conclusion. Future cases in Washington and other jurisdictions with similar facts and the same security agreement language could come out differently.

This possibility of divergent holdings interferes with the expansion of commercial lending, another policy of the UCC, because the future effects of a security agreement are not foreseeable by creditors and debtors. Lack of predictability brought about by a loose construction of security agreements threatens the extension of credit by lenders considering loans to debtors who have already granted personal property to another party as collateral. The UCC's requirement that the security agreement reasonably identify the collateral exists for two reasons. First, the section requires that there be sufficient evidence of the extent of the collateral encumbered by the parties in order to avoid later disputes. Second, the requirement protects subsequent lenders by offering more detailed evidence of the intent of prior lenders' security than a publicly filed financing statement. These potential lenders will not be able to predict the full extent of the security of prior creditors, such as Rainier Bank in the Bachmann case. The capital needs of businesses, including farms, may go unmet.

Moreover, the purposes and policies of the DTP do not alter the effect of section 9-306(1). The purpose of the DTP is to eliminate farmers from the dairy business by giving them the resources to

94. See supra notes 88–92 and accompanying text.
96. Id. § 9-203 official comment 5.
97. Id. § 9-402 official comment 2 (“Further inquiry from the parties concerned [beyond a look at the financing statement] will be necessary to disclose the complete state of affairs.”); see J. WHITE & R. SUMMERS, supra note 81, § 22-3, at 966. White and Summers view the security agreement and its adequate description of collateral as embracing not only a statute of frauds concern between the two parties to the security agreement, but also the protection of other lenders. Beyond a look at the publicly filed financing statement when determining which property of a debtor is unencumbered, “a look at the signed security agreement is a logical second step.” Id. This policy has been articulated in Washington, before and after the enactment of Article 9. WASH. REV. CODE ANN. § 62A.9-110 Washington comments (1966); see Shattuck, Secured Transactions (Other Than Real Estate Mortgages)—A Comparison of Article 9 of the Uniform Commercial Code and the Pre-Code Washington Law, in THE UNIFORM COMMERCIAL CODE IN WASHINGTON 661 n.36 (1967); see also supra note 85.
98. See supra notes 32–35 and accompanying text.
change occupations. Farmers are free, however, to dispose of the DTP payments as they wish, even by assigning them to other creditors. No clear policy is therefore articulated by the DTP with respect to agricultural lending; on the contrary, it appears that the DTP is not meant to interfere with private contracts. Accordingly, the secured creditor may claim DTP payments only if the payments are proceeds of livestock.

B. *The Extent of a Creditor’s Security Interest Upon Disposition of the Collateral*

1. *An Examination of the Parties’ Collateral*

   The first step a court should take in analyzing a proceeds question like the one presented in *Bachmann* is to determine the extent of the creditor’s security interest. This must be done by examining the words used to describe the collateral in the security agreement. Such an examination of language must take into account the understanding of the parties to the agreement as well as third parties. If the description is clear on its face, with no suggestion that more than the stated collateral is encumbered, the court should conclude that the parties intended only the stated collateral be security for the transaction.

   The security agreement at issue in *Bachmann* indicated that the parties intended “livestock” as their collateral. Nothing in this security agreement indicated that more than cattle, as they are commonly viewed, was meant to act as security. There was no need to further construe “livestock.”

   After the court determines the extent of the security agreement, it must determine whether the described collateral was “disposed of.” In *Bachmann*, the cattle were disposed of when the debtors entered into the DTP and when they sold the animals. When they entered the DTP, the Bachmanns caused the value of their cattle to drop in value from their market value to their slaughter value, and this itself was a disposition. Diminution in the value of a creditor’s security interest may lead to a disposition of that security interest. For example, the involuntary destruction of collateral results in “proceeds” in insurance...
cases,\textsuperscript{104} and action other than transferring collateral to another party may be a “disposition”\textsuperscript{105} with the money received being proceeds.\textsuperscript{106} Thus, the security the bank foresaw, the cattle, was disposed of by the Bachmanns. The question remaining, therefore, is what was received upon this disposition?

2. “Disposition” and the Limits of “Whatever is Received”

a. An Amendment to Section 9-306 is Not Appropriate

The limits of “proceeds” should not be defined in the realm of government subsidies through an amendment to section 9-306(1). Interpretive problems concerning whether insurance payments for the destruction of collateral were proceeds resulted in an amendment of section 9-306(1) to resolve the issue.\textsuperscript{107} Drafting a useful amendment dealing with agricultural subsidies, however, would be a difficult and unwarranted exercise. Such a statute would be too broad if it included all subsidy payments, because there are real differences between agricultural subsidy programs and their relation to various types of collateral. The variation between government subsidy programs would also make an amendment too unwieldy. A statute that attempted to distinguish subsidy programs would be long and nearly impossible to draft because it would have to incorporate the details of current programs and predict the details of future programs. The question whether DTP payments are proceeds of livestock is best answered by applying the current provisions of the UCC.


\textsuperscript{105} The maxim of \textit{ejusdem generis} would require that because “disposition” follows “sale” and “exchange” in § 9-306(1), its definition must similarly be limited to a transfer of property. \textit{Ejusdem generis} counsels that general words following specific ones should be construed to operate like the specific words. Weisbart & Co. v. First Nat'l Bank of Dalhart, 568 F.2d 391, 395 (5th Cir. 1978); Borg-Warner Acceptance Corp. v. C.I.T. Corp., 679 S.W.2d 140, 143 (Tex. App. 1984). However, the limits of “proceeds” are not satisfactorily defined by this principle. Given the tendency of many courts to find that the 1972 amendment to § 9-306 merely codified the UCC's original intent that destruction of collateral be a “disposition” and insurance payments be proceeds, Ettinger v. Central Pa. Nat'l Bank, 634 F.2d 120, 125 (3d Cir. 1980), “other disposition” is not always a transfer of property.


\textsuperscript{107} U.C.C. § 9-306(1) (1987) (“Insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement.”); see Skilton, The Secured Party's Rights in a Debtor's Insurance Under Article 9 of the Uniform Commercial Code (and Related Matters), 1978 S. ILL. U.L.J. 500, 505–21.

777
b. A Quid Pro Quo Approach to Defining “Proceeds”

The most useful approach for determining what is received upon disposition of collateral in “proceeds” cases is to examine the relationship between the total payment received by the debtor and the value of the collateral disposed of. Forms of this approach have been applied in the context of DTP payments,\textsuperscript{108} payments under the PIK program,\textsuperscript{109} other subsidy payments,\textsuperscript{110} and in cases outside the realm of government subsidies.\textsuperscript{111} Courts should link the value of the collateral to the “proceeds” claimed in order to ensure that the payment in question was received upon the disposition of the collateral, and not from some other source.\textsuperscript{112}

In the Bachmann case, this principle would have resulted in only the portion of the DTP money attributable to the market value of the Bachmanns’ cattle being awarded to the bank. Under this analysis, the entire DTP amount was not received upon a “disposition” of the cattle. This result would have achieved a better balancing of the policies of the UCC and the DTP, while avoiding a windfall to secured creditors by going beyond the contractual terms of the security agreement.

The DTP payments included compensation for elements of the Bachmanns’ personal property not covered by their security agreement with Rainier Bank. The payments, determined by farmers’ bids, are based on an entire range of factors other than cattle relating to a dairy farm. First, the bid amount must take into account future profits that will be forgone by entering the program and leaving ownership of a dairy business. This prediction takes its shape by considering sev-


\textsuperscript{109} The opinion in In re Judkins, 41 Bankr. 369 (Bankr. M.D. Tenn. 1984), is an example of a quid pro quo approach to proceeds in the PIK program context. In Judkins, the court required that a creditor prove a “nexus” between the PIK payments and the collateral originally encumbered by the security agreement. \textit{Id.} at 373 n.5; cf. In re Schmaling, 783 F.2d 680, 683 (7th Cir. 1986) (there must be collateral to dispose of in order for there to be proceeds; thus PIK payments are not proceeds if crops are not grown).

\textsuperscript{110} In re Frasch, 53 Bankr. 89, 90 (Bankr. D.S.D. 1985) (Milk Diversion Payments are in return for a contract to produce less milk, not proceeds of milk produced).


\textsuperscript{112} Seaman, 469 So.2d at 248. In Seaman, the court held that the secured party has the burden of proving that the proceeds claimed arose directly from the sale or disposition of the collateral and not from any other source. \textit{Id.} at 247.
eral factors, such as the individual management success of each farmer and the non-cattle elements of the business. Second, the payments eliminate the risk associated with this predicted profit. For example, the payments eliminate the possibility of a reduction in profits due to unforeseen cattle disease or destruction of crops used as feed grain. Finally, the DTP amount must also be high enough to coax dairy farmers to leave their chosen profession and seek a new source of livelihood.

The cattle, the collateral in Bachmann, were disposed of by the Bachmanns in compliance with the DTP, but only a portion of the payments received were a product of the disposition of cattle. There were two elements of the disposition of this collateral. First, the Bachmanns disposed of the cattle when they sold them for slaughter, and the auction proceeds were undoubtedly “proceeds” under Article 9. Second, the Bachmanns “disposed of” their cattle when they entered the DTP and they parted with the value of the herd that could have been realized on the open market. A quid pro quo approach to “other disposition” would have granted as proceeds the money received from the auction of the cattle, and the difference between the market value of the cattle and their slaughter value at auction. The total proceeds would therefore equal the market value of the described collateral.

The UCC policy of expansion of commercial lending, through uniformity and predictability, would have been better served by this result. The court's dependence on the “factual context” of Bachmann for its conclusion may lead to inconsistent holdings in Washington and in other jurisdictions. In contrast, discerning the parties' intent by first examining the language in the security agreement would encourage consistent intent holdings among various jurisdictions. When the UCC's terms are used without any modification by the parties to a security agreement, the thing claimed as “proceeds” must fit under its statutory definitions. If parties desire to go beyond the bare framework of the UCC's definitions, they may expressly modify

113. See 7 C.F.R. § 1430.455(a) (1988) (the contract base may only be calculated based on quantities of milk marketed for which the contracting dairy farmer shared in the risk of production).

114. The most prevalent operational structure in dairy farming is the family-oriented farm, where a large portion of the feed for the cattle is grown on the farm. T. FREY & R. BEHRENS, LENDING TO AGRICULTURAL ENTERPRISES 263 (1981).

115. See supra notes 93-97 and accompanying text.

116. J. WHITE & R. SUMMERS, supra note 81, § 22-4, at 974. Of course, if the definition of proceeds is broad enough to cover something, then usually an intent analysis is unnecessary. Most courts agree. Id. at 978.
them. Uniformity among jurisdictions is more likely to be achieved as terms defined within Article 9 or clearly defined by the parties are used to express the agreement of the parties. Creditors may more easily gauge the security they require and other lenders may more easily coexist when security agreements are interpreted according to their terms.

IV. CONCLUSION

The court in *Bachmann* went too far in granting Rainier Bank an interest in the entire DTP amount, because the language employed by the parties was not broad enough to encompass more than livestock as collateral. The DTP payments were based on items of the Bachmanns' personal property not covered by the language of the parties' security agreement. In order to claim the entire payment, Rainier Bank should have evidenced in its security agreement an intent to include more than livestock as collateral.

The cattle encumbered in *Bachmann* were "disposed of" under UCC § 9-306, but only so much of the DTP payments as reflected the value of the collateral was actually proceeds of the cattle. This conclusion results from applying a quid pro quo analysis to determine what is received upon the disposition of the collateral at issue. In *Bachmann*, this analysis would have given Rainier Bank as proceeds the market value of the cattle. This result would have better achieved the goals of the UCC of uniformity and the expansion of commercial lending practices.

*Thomas L. Weinberg*

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