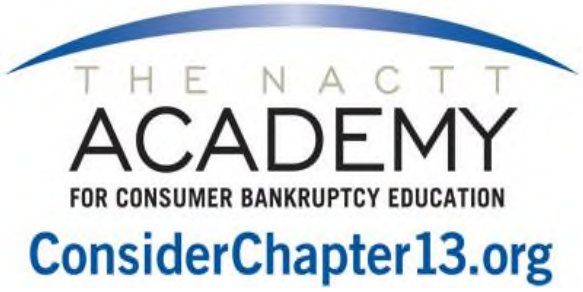

CREDIT UNION ISSUES IN CHAPTER 13 CASES

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CREDIT UNIONS & CROSS-COLLATERIZATION

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1. **SOURCE OF THE LAW**

Revised Article 9 (revised in 2001) made cross-collateralization provisions much more broadly enforceable.

a. UCC Section 9-204(a) text: "[After-acquired collateral.] Except as otherwise provided in subsection (b), a security agreement may create or provide for a security interest in after-acquired collateral."
    i. Comment 2 of UCC "2. After-Acquired Property; Continuing General Lien. **Subsection (a) makes clear that a security interest arising by virtue of an after-acquired property clause is no less valid than a security interest in collateral in which the debtor has rights at the time value is given**. A security interest in after-acquired property is not merely an "equitable" interest; no further action by the secured party--such as a supplemental agreement covering the new collateral--is required. This section adopts the principle of a "continuing general lien" or "floating lien." It validates a security interest in the debtor's existing and (upon acquisition) future assets, even though the debtor has liberty to use or dispose of collateral without being required to account for proceeds or substitute new collateral. See Section 9-205. Subsection (a), together with subsection (c), also validates "cross-collateral" clauses under which collateral acquired at any time secures advances whenever made."
b. UCC Section 9-204(c) text: "[Future advances and other value.] A security agreement may provide that collateral secures, or that accounts, chattel paper, payment intangibles, or promissory notes are sold in connection with, future advances or other value, whether or not the advances or value are given pursuant to commitment."
    i. Comment 5 of UCC: 5. "Future Advances; Obligations Secured. Under subsection (c) collateral may secure future as well as past or present advances if the security agreement so provides. This is in line with the policy of this Article toward security interests in after-acquired property under subsection (a). Indeed, the parties are free to agree that a security interest secures any obligation whatsoever. Determining the obligations secured by collateral is solely a matter of construing the parties' agreement under applicable law. **This Article rejects the holdings of cases decided under former Article 9 that applied other tests, such as whether a future advance or other subsequently incurred obligation was of the same or a similar type or class as earlier advances and obligations secured by the collateral.**"

2. **LOAN DOCUMENTS**

Examples of cross-collateralization clauses in loan and credit card agreements:

a. Credit Union in-house loan agreement:
    i. Truth-in-Lending Disclosure: "Security: You are giving a security interest in personal property (other than household goods or any dwelling) securing other loans with Us."
    ii. Loan Agreement: "Collateral (other than household goods or any dwelling) given as security under this Agreement or for any other loan You may have with Us will secure all amounts You owe Us now and in the future if that status is reflected in the 'Truth-in-Lending Disclosure' in any particular Agreement evidencing such debt."

3. CHAPTER 13 PROOFS OF CLAIM ISSUES

a. Using a single claim for multiple debts if secured by the same collateral vs. separate claims for each account

    i. Problems with single claim:
        1. Internal accounting of creditor about how to apply trustee checks to each debt when only receiving a single check . Pro rata?
        2. Multiple debts likely to have interest rates different from each other, but proof of claim form only allows for one interest rate.
        3. Separate account numbers for multiple debts, but proof of claim only allows for one account number
        4. Arrearages on multiple debts but proof of claim form only allows you to list one arrearage amount.

b. Multiple pieces of collateral securing a single debt
    i. Providing value for each piece collateral in the proof of claim

c. Documentation to support cross-collateralized security interest:
    i. Including all loan agreements and evidence of perfection to support the cross-collateralization alleged for that claim. E.g., cross-collateralized credit card proof of claim to include a copy of the credit card agreement, plus the cross-collateralized auto loan agreement and certificate of title.

d. Amended proofs of claim after liquidation of collateral
    i. How to apply the net sale amount after sale of liquidated collateral when there are cross-collateralized debts.

4. PLAN TREATMENT OF CROSS-COLLATERALIZED CLAIMS

a. Some plan forms are more "collateral-oriented" and not "debt-oriented"
    i. Some jurisdictions have plans that are more collateral-oriented, assuming that multiple debts cannot be secured by the same collateral, or assuming that a single debt does not have multiple pieces of collateral. Difficulty in administering.
    ii. Each claim that is secured should have an entry and treatment, even if claims are cross-collateralized. This is rarely done.

b. Direct payments
    i. Common problem of listing the creditor and the collateral for direct payments, but not specifically referring to all the cross-collateralized debts secured by the collateral. E.g., auto loan listed for direct payments, but fails to address a cross-collateralized credit card or personal loan.

c. Cram down
    i. If multiple debts are secured by a single piece of collateral, and there is a claim filed for each debt, which debts have their secured claim amount reduced as a result of a cram down?
    ii. If a single debt is secured by multiple pieces of collateral, and there is a cram down, ensuring that each piece of collateral has a distinct valuation as opposed to a combined valuation that does not identify the value of each piece of collateral.

d. Surrender issues when there are cross-collateralized debts, or a single debt secured by multiple pieces of collateral.
    i. Partial surrender?

5. **EXCEPTIONS TO CROSS-COLLATERALIZATION CLAUSES**

a. Real Estate

b. Retail Installment Contracts assigned to lenders. Lack of cross-collateralization language (not original lender).

6. **MONEY ON DEPOSIT**

a. Security interest in money on deposit (through cross-collateralization clauses or otherwise)

7. **CASE LAW DECISIONS**[1]

a. **Selecting different options (surrender, retain) for different collateral securing same claim:** *Evolve Fed. Credit Union v. Barragan-Flores* (In re Barragan-Flores), 984 F.3d 471 (5th Cir. 2021):
    i. [1] A Chapter 13 bankruptcy plan that proposed retention of a vehicle, cramdown of the loan for its purchase, and surrender of another vehicle as the collateral for the loan for its purchase was contrary to 11 U.S.C.S. § 1325(a)(5) because the loans for the vehicles were cross-collateralized and the debtor could not select different options for different collateral securing the same claim; [2] Although the text of § 1325(a)(5) allowed a debtor to select a different option with respect to each allowed secured claim, the use of the conjunction "or" between the options made clear that a debtor could choose only one of those three options for each claim and

[1] Case Summary holdings from LexisNexis

had to select the same option for all of the collateral securing a single claim; the proposed plan violated that requirement by selecting different options for different collateral securing the same claim.

b. **910 claim status with cross-collateralized debt:** *In re Robinson*, 2019 Bankr. LEXIS 3179 (Bankr. SD Fl (2019)
    i. [1]-There was nothing in the hanging paragraph of 11 U.S.C.S. § 1325(a) that would lead the court to conclude that the existence of the cross-collateralization clause in the security agreement between debtors and the credit union rendered the hanging paragraph inapplicable; [2]-The statute required that the credit union have a purchase money security interest, and the credit union did in fact have a purchase money security interest in the vehicle. That the vehicle may also have been collateral for other obligations did not diminish this fact; [3]-The statute required that the collateral for the debt before the court be a vehicle acquired for the personal use of the debtors. In this case, the subject vehicle was purchased for the debtors' personal use and was indeed the collateral securing the credit union's claim; [4]-Debtors could not seek valuation of the subject vehicle.

c. **Applying total value of all collateral to all cross-collateralized debts:** *In re Hobart*, 452 B.R. 789 (Bankr. D ID 2011)
    i. At the time the debtors declared bankruptcy, they owned a sport utility vehicle ("SUV"), a pickup truck, and a recreational vehicle ("RV") and they owed a credit union money on loans they obtained to buy all three vehicles. The debtors decided to surrender the RV to the credit union and to keep the SUV and the pickup truck, and they proposed a bankruptcy plan that proposed to pay the credit union $776 on the SUV and $3,003 on the truck. The credit union filed an objection to debtors' plan, claiming that the debtors were not paying enough on the SUV and the pickup truck because the debt they owed on the RV was cross-collateralized by the SUV and the truck. The court found that agreements the debtors signed when they borrowed money from the credit union provided that all collateral securing one loan with the credit union would secure all other debts the debtors owed to the credit union, and the entire value of the SUV and the pickup truck were encumbered by the credit union's claims.

d. **Applying value of one vehicle to two different claims both secured by the vehicle where there is enough equity to do so.** *In re Albert*, 2006 Bankr. LEXIS 4588 (Bankr. SD OH 2006)
    i. The credit union filed a claim against the debtors' bankruptcy estate, claiming that it loaned money to the debtors in 2000 so they could purchase a vehicle (vehicle #2), and that the claim was secured in the amount of $ 5,445.26 against a vehicle the debtors already owned (vehicle #1). The trustee filed an objection to the claim, contending that an

agreement the debtors signed which gave the credit union a security interest in vehicle #1 was invalid. The court found that a cross-collateralization clause that was included in the loan agreement the debtors signed when they purchased vehicle #2, which gave the credit union a security interest in vehicle #1, was valid under Ohio Rev. Code Ann. § 1309.204, and because vehicle #1 was worth more than the amount of the loan the debtors owed on vehicle #1, the credit union's loan on vehicle #2 was secured to the extent of the excess value, even though the debtors no longer owned vehicle #2.

CROSS-COLLATERALIZATION - EXAMPLES

Beverly M. Burden
May 7, 2021

EXAMPLE #1:

Car loan 01/01/2015	Security: You are giving a security interest in your shares and/or deposits in the Credit Union. You are also giving a security interest in the purchased motor vehicle described below: 2012 Nissan Altima, VIN #xxxxxx, value $18,275.
"Signature" loan 01/01/2017	Security: You are giving a security interest in your shares and/or deposits in the Credit Union.

Does the car secure the signature loan? No. There is no indication in either security agreement that the collateral for one loan would secure other loans.

UCC Sec. 9-204(c): "A security agreement may provide that the collateral secures . . . future advances or other value . . . ."

Comment 5 of UCC Sec. 9-204: "[C]ollateral may secure future as well as past or present advances if the security agreement so provides."

Note, though, that both loans are secured by the debtor's deposit accounts with the Credit Union.

EXAMPLE #2:

Car loan 01/01/2015	Security: Collateral securing other loans with the Credit Union will also secure this loan. You are giving a security interest in your shares and/or deposits in the Credit Union. You are also giving a security interest in the purchased motor vehicle described below: 2012 Nissan Altima, VIN #xxxxxx, value $18,275. The security interest secures the loan and also secures any other loans, including any credit card loans, that you have now or receive in the future and any other amounts you owe us for any reason now or in the future, except any loan secured by your principal dwelling or household goods.
"Signature" loan 01/01/2017	Security: Collateral securing other loans with the Credit Union will also secure this loan. You are giving a security interest in your shares and/or deposits in the Credit Union.

Does the car secure the signature loan? Yes. The security agreement for the car includes a "cross-collateralization" clause specifying that the security interest in the car also secures all other loans. The security agreement for the signature loan also evidences the parties' intention that the car would secure the signature loan.

See In re Brannan, 2011 WL 2076378 (Bankr. Mont. 2011); *In re Watson*, 286 B.R. 594 (Bankr. N.J. 2002).

EXAMPLE #3:

Signature loan 01/01/2012	Security: Collateral securing other loans with the Credit Union will also secure this loan. You are giving a security interest in your shares and/or deposits in the Credit Union.
Car loan 01/01/2015	Security: Collateral securing other loans with the Credit Union will also secure this loan. You are giving a security interest in your shares and/or deposits in the Credit Union. You are also giving a security interest in the purchased motor vehicle described below: 2012 Nissan Altima, VIN #xxxxxx, value $18,275. The security interest secures the loan and also secures any other loans, including any credit card loans, that you have now or receive in the future and any other amounts you owe us for any reason now or in the future, except any loan secured by your principal dwelling or household goods.
Credit card 01/01/2019	Signature: I understand that a security interest is a condition for the credit card account and I grant Credit Union a security interest in all shares and/or deposits in the Credit Union. I also understand that collateral securing other debts at Credit Union also secures this indebtedness, except for my principal residence and household goods.

Does the car secure the earlier signature loan? Yes.. The security agreement for the car provides that the car secures "any other loans . . . that you have now or receive in the future . . . ."

Does the car secure the credit card debt? Probably. The security agreement for the car clearly states that the car secures any other loans "including any credit card loan." However, there might be some issue as to whether the notice in the credit card application is clear and conspicuous enough to be binding.

See In re Dumlao, 2011 WL 4501402 (9th Cir. BAP 2011); *In re Zaochney*, 2011 WL 6148727 (Bankr. Alaska 2011); *In re Christy*, 2004 WL 5993578 (Bankr. D. Kan. 2004).

EXAMPLE #4

Car loan 01/01/2015	Security: Collateral securing other loans with the Credit Union will also secure this loan. You are giving a security interest in your shares and/or deposits in the Credit Union. You are also giving a security interest in the purchased motor vehicle described below: 2012 Nissan Altima, VIN #xxxxxx, value $18,275. The security interest secures the loan and also secures any other loans, including any credit card loans, that you have now or receive in the future and any other amounts you owe us for any reason now or in the future, except any loan secured by your principal dwelling or household goods.
Car loan 01/01/2017	Security: Collateral securing other loans with the Credit Union will also secure this loan. You are giving a security interest in your shares and/or deposits in the Credit Union. You are also giving a security interest in the purchased motor vehicle described below: 2006 Lexus RX 330, VIN #xxxxxx, value $10,875. The security interest secures the loan and also secures any other loans, including any credit card loans, that you have now or receive in the future and any other amounts you owe us for any reason now or in the future, except any loan secured by your principal dwelling or household goods.

Debtor pays off the 2015 loan on the Nissan and defaults on the 2017 loan on the Lexus. Can the CU still repossess the Nissan to satisfy the debt on the Lexus? Yes. The credit union can repossess both vehicles even though the loan has been paid off on one of them (provided the lien on the Altima has not been released). Also, the CU has no obligation to release the lien on either car until all loans with the CU have been paid in full.

See In re Conte, 206 F.3d 536 (5th Cir. 2000); *In re Howard*, 312 B.R. 840 (Bankr. W.D. Ky. 2004) (applying more restrictive pre-2001 UCC provisions); *In re Watson*, 286 B.R. 594 (Bankr. N.J. 2002).

SAMPLE CLAUSES THAT MAY INDICATE CROSS-COLLATERIZATION

Security: Collateral securing other loans with the credit union will also secure this loan
You are giving a security interest in your shares and/or deposits in the credit union.
Security: You are giving a security interest in the Motor Vehicle purchased

Security: Collateral securing other loans with the Credit Union may also secure this loan. You are giving a security interest in your shares and dividends and, if any, your deposits and interest in the Credit Union; and the property described below:

Collateral	Property/Model/Make	Year	I.D. Number	Type	Value	Key Number
	2012 Nissan Altima		[redacted]		$ 18,275.00	
					$ 0.00	

Security: Collateral securing other loans with the credit union will also secure this loan
You are giving a security interest in your shares and/or deposits in the credit union.

See the Note and Security Agreement on the reverse for any additional information about security interest, nonpayment, cross collateralization, default, cross default, any required payment in full before the scheduled date, and penalties. Filing Fee _____ Non-Filing Insurance _____
PREPAYMENT: If you pay off early, you will not have to pay a penalty, and you will not be entitled to a refund of part of the finance charge.
☐ **REQUIRED DEPOSIT:** The ANNUAL PERCENTAGE RATE does not take into account your required deposit, if applicable.
LATE CHARGES: If your payment is more than 10 days late, you may be charged 5% of the payment or $5.00, whichever is more.
PROPERTY INSURANCE: You may obtain property insurance from anyone you want that is acceptable to the Credit Union.
ASSUMABILITY: Your loan is not assumable.
SECURITY:
☐ The goods or property being purchased. ☐ Cross Collateral Clause ☐ Other
☐ Your present and future shares or deposits in the Credit Union. ☐ Personal property (other than household goods or any dwelling) securing other loans with Us.

LOAN AGREEMENT

4. SECURITY FOR LOAN - This Agreement is secured by all property described in the "Security" section of the Truth in Lending Disclosure. Property securing other loans you have with us also secures this loan, unless the property is a dwelling. In addition to your pledge of shares, we may also have what is known as a statutory lien on all individual and joint accounts you have with us. A statutory lien means we have the right under federal law and many state laws to claim an interest in your accounts. We can enforce a statutory lien against your shares and dividends, and if any, interest and deposits, in all individual and joint accounts you have with us to satisfy any outstanding financial obligation that is due and payable to us. We may exercise our right to enforce this lien without further notice to you, to the extent permitted by law. ***For all borrowers:*** You pledge as security for this loan all shares and dividends and, if any, all deposits and interest in all joint and individual accounts you have with the Credit Union now and in the future. **The statutory lien and/or your pledge will allow us to apply the funds in your account(s) to what you owe when you are in default.** The statutory lien and your pledge do not apply to any Individual Retirement Account or any other account that would lose special tax treatment under state or federal law if given as security.

SECURITY AGREEMENT

1. THE SECURITY FOR THE LOAN - You give us what is known as a security interest in the property described in the "Security" section of the Truth in Lending Disclosure that is part of this document ("the Property"). The security interest you give includes all accessions. Accessions are things which are attached to or installed in the Property now or in the future. The security interest also includes any replacements for the Property which you buy within 10 days of the Loan and any extensions, renewals or refinancings of the Loan. It also includes any money you receive from selling the Property or from insurance you have on the Property. If the value of the Property declines, you promise to give us more property as security if asked to do so.

2. WHAT THE SECURITY INTEREST COVERS/CROSS COLLATERAL PROVISIONS - The security interest secures the Loan and any extensions, renewals or refinancings of the Loan. **The security interest also secures any other loans, including any credit card loan, you have now or receive in the future from us and any other amounts you owe us for any reason now or in the future, except any loan secured by your principal dwelling.** If the Property is household goods as defined by the Federal Trade Commission Credit Practices Rule or your principal dwelling, the Property will secure only this Loan and not other loans or amounts you owe us.

Note and Security Agreement

PROMISE TO PAY: To repay your loan, You jointly and severally, promise to pay to us at our office or to our order the "Total of Payments" (shown above) in lawful money of the United States. The minimum scheduled amount due for each payment is set forth in the payment schedule (shown above). You understand that each payment is applied first to Collection Costs and late charges, if any, and any other fees and charges, if any, then to FINANCE CHARGES, and then to the Amount Financed. Payments will continue until you have paid in full the Amount Financed, FINANCE CHARGES and any other fees and charges.

CONTRACTUAL LIEN ON ACCOUNTS: In addition to the above security, you give to us a contractual lien (i.e., a security interest) on all funds in any share account (including, but not limited to, your share, share draft and share certificate accounts, but excluding IRA account(s)) with us on which you are a signatory or in which you have an ownership interest now or in the future, regardless of the source of the funds. You agree that we may use such funds, without notice, to pay any debts or amounts owed to us by you, other than obligations secured by real property or where otherwise prohibited by federal or state law or regulation.

ADDITIONAL SECURITY (CROSS COLLATERALIZATION): You understand and agree that any property or property right (whether tangible or intangible) securing other loans or lines of credit with us shall also secure this loan. Further, the property given as security under this Loan shall also secure any other loans or lines of credit you owe us now or in the future (except any loan, line of credit or other agreement secured by real property or where otherwise prohibited by federal or state law or regulation). See below and page 2 for important additional terms and information.

Security: To secure all transactions under this Agreement in either joint or individual Accounts, we have the right to impress and enforce a statutory lien against your shares on deposit with us (except IRA or KEOGH accounts), and any dividends due to you from the Credit Union to the extent that you owe any unpaid balance on your Account(s) and we may enforce our right to do so without further notice to you. Additionally, you agree that we may set-off any mutual indebtedness on your Account with such shares.

Visa Credit Card Application

[redacted]

[redacted] Federal Credit Union

SIGNATURES

I/We understand that by signing this application, I/we promise to pay all amounts charged and advanced in accordance with the terms and conditions set forth in the Credit Cardholder Disclosure that I/we will receive with my/our [redacted] Credit Union credit card. I/We understand that a security interest is a condition for the credit card account and I/we grant [redacted] a security interest in all funds, now or hereafter, in the [redacted] accounts specified on this application (except IRAs) and if I/we default under the terms of this agreement, I/we authorize [redacted] to apply such funds to the payment of my/our credit card indebtedness. I/We also understand that collateral securing other debts at [redacted] also secures this indebtedness, except for my principal dwelling and household goods.

VALUATION ISSUES IN CHAPTER 13 WHEN LOANS ARE PROPERLY CROSS-COLLATERALIZED

Debtor has 3 loans with the credit union:
Claim #1 –.$2,000 based on 01/01/2012 signature loan bearing interest at 16 %.
Claim #2 – $9,000 based on 01/01/2015 car loan with a proper cross-collateralization clause.
Claim #3 - $1,500 based on 01/01/2019 credit card bearing interest at 13%.

If the car is worth $12,000:

Claim #2: $9,000 Car loan 01/01/2015	Fully secured at $9,000.
Claim #1: $2,000 Signature loan 01/01/2012	Also fully secured at $2,000
Claim #3: $1,500 Credit card 01/01/2019	Secured to the extent of $1,000 ($12,000 value, minus claim for $9,000, minus claim for $2,000, leaves $1,000 of value to attach to any other cross-collateralized loans). Balance of claim - $500 – is unsecured.

If the car is worth $8,000:

Claim #2: $9,000 Car loan 01/01/2015	Secured to $8,000; unsecured to $1,000.
Claim #1: $2,000 Signature loan 01/01/2012	Unsecured $2,000
Claim #3: $1,500 Credit card 01/01/2019	Unsecured $1,500

Same loans, except Claim #2 for $9,000 is based on a 01/01/**2020** car loan with a proper cross-collateralization clause, and the loan is a **910-claim** not subject to valuation).

If the car is worth $12,000:

Claim #2: $9,000 Car loan 01/01/2020	Secured at $9,000 (it's a 910-claim so it must be paid in full regardless of value).
Claim #1: $2,000 Signature loan 01/01/2012	Fully secured at $2,000 ($12,000 car value minus $9,000 debt owed on the 910-claim).
Claim #3: $1,500 Credit card 01/01/2019	Secured to the extent of $1,000 ($12,000 value, minus claim for $9,000, minus claim for $2,000, leaves $1,000 of value to attach to any other cross-collateralized loans). Balance of claim - $500 – is unsecured.

If the car is worth only $8,000:

Claim #2: $9,000 Car loan 01/01/2015	Secured for $9,000 (it's a 910-claim so it must be paid in full regardless of value).
Claim #1: $2,000 Signature loan 01/01/2012	Unsecured $2,000
Claim #3: $1,500 Credit card 01/01/2019	Unsecured $1,500

Even if the car loan is a 910-claim, section 506 still applies to value the other cross-collateralized loans. The cross-collateralized claims are not 910-claims because they do not constitute purchase money security interests.

See In re Villarreal,566 B.R. 859 (Bankr. S.D. Tex. 2017); *In re Hobart*, 452 B.R. 789 (Bankr. Idaho 2011); *In re Sanders*, 2006 WL 3386739 Bankr. C.D. Ill. 2006)

Security Interests in Deposit Accounts

Beverly M. Burden
May 7, 2021

Most (if not all) credit union loans include a provision whereby the debtor grants to the credit union a security interest in the debtor's shares and deposit accounts at the credit union. The security interest is perfected by reason of the credit union's "control" over the accounts. This security interest in deposit accounts is in addition to any common law or statutory right of setoff.

UCC Provisions Regarding Security Interests in Deposit Accounts

The relevant provisions of the UCC are as follows:

> UCC Section 9-102. Definitions and Index of Definitions.
>
> > (a) [Article 9 definitions.] In this article:
> >
> > > (8) "Bank" means an organization that is engaged in the business of banking. The term includes savings banks, savings and loan associations, credit unions, and trust companies.
> > >
> > > . . . .
> > >
> > > (29) "Deposit account" means a demand, time, savings, passbook, or similar account maintained with a bank. The term does not include investment property or accounts evidenced by an instrument.
> > >
> > > . . . .

> UCC Section 9-304. Law Governing Perfection and Priority of Security Interests in Deposit Accounts.
>
> > (a) [Perfection by control.] A security interest in . . . deposit accounts . . . may be perfected by control of the collateral under Section 9-104 . . . .
> >
> > (b) [Specified collateral: time of perfection by control; continuation of perfection.] A security interest in deposit accounts, . . . is perfected by control under Section 9-104 . . . when the secured party obtains control and remains perfected by control only while the secured party retains control.

UCC Section 9-104. Control of Deposit Account.

> (a) [Requirements for control.] A secured party has control of a deposit account if:
>
> > (1) the secured party is the bank with which the deposit account is maintained;
> >
> > . . . .
>
> (b) [Debtor's right to direct disposition.] A secured party that has satisfied subsection (a) has control, even if the debtor retains the right to direct the disposition of funds from the deposit account.

UCC Section 607. Collection and Enforcement by Secured Party.

> (a**)** [Collection and enforcement generally.] If so agreed, and in any event after default, a secured party:
>
> . . .
>
> > (4) if it holds a security interest in a deposit account perfected by control under Section 9-104(a)(1), may apply the balance of the deposit account to the obligation secured by the deposit account; . . .

Enforceability of Security Interest – in General

The credit union with a security interest in deposit accounts is permitted (outside of bankruptcy) to apply funds in the deposit account against loans in default. The security interest may be valid and enforceable against joint accounts or against accounts consisting of social security payments.

In re Perez, 440 B.R. 634 (Bankr. N.J. 2010) (credit union's lien was perfected by control over certificate of deposit debtor maintained at the credit union; security interest was not avoidable by trustee).

In re Cabrera, 2009 WL 4666460 (Bankr. S.D. Fla. 2009) (debtor's grant of security interest in deposit account consisting of debtor's wages was valid and constituted a waiver of exemptions up to the amount of the debt owed).

Enforceability of Security Interest Against Joint Accounts:

In re Brooks, 2013 WL 12233950 (Bankr. N.D. Fla. 2013) (debtor granted credit union a security interest in all deposit accounts by signing credit card application; security interest extended to joint accounts)

In re Houston, 2012 WL 4490890 (E.D. Mich. 2012) (under Michigan law, credit union's lien in deposit account securing a credit card debt enforceable against entire joint account regardless of source of funds)

Enforceability of Security Interest Against Accounts With Social Security Benefits:

Lakewood Credit Union v. Goodrich, 372 Wis.2d 84 (Wis. Ct. App. 2016) (relying on *Washington State Dept. of Social & Health Services v. Guardianship Estate of Keffeler*, 537 U.S. 371, 123 S.Ct. 1017 (2003), debtor's grant of security interest in deposit account consisting of social security benefits did not violate provision in section 407 of the Social Security Act protecting such benefits from "execution, levy, attachment, garnishment, or other legal process."):

In re Ward, 464 B.R. 471 (Bankr. N.D. Ga. 2011)

In re Ball, 573 B.R. 708 (Bankr. E.D. Ky. 2017)

Administrative Freeze

Upon the filing of a bankruptcy petition, the credit union may impose an administrative freeze on the deposit account without violating the automatic stay. *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 116 S.Ct. 286 (1995). However, the credit union should promptly seek relief from stay in order to enforce its lien or apply its right of setoff. *See Town of Hempstead Employees Federal Credit Union v. Wicks*, 215 B.R. 316 (E.D.N.Y. 1997) (four-month long administrative freeze constituted a setoff in violation of the automatic stay).

Valuation

As with any other collateral, a credit union's security interest in a deposit account is valued at the time of the petition. If the account balance is $0, the credit union's claim is unsecured in a chapter 13 case. *In re Hermer*, 2013 WL 3866513 (Bankr. C.D. Ill. 2013).

FRBP 7004 Service on Credit Unions

By Taylor Jones, Law Clerk, Hon. Brian Lynch

When FRBP 7004 service is required:

Adversary proceedings: Federal Rule of Bankruptcy Procedure ("FRBP") 7004 service of the summons and complaint is required to initiate any adversary proceeding listed in FRBP 7001.

Contested matters: Pursuant to FRBP 9014(a), relief in contested matters must be requested by motion. That motion must be served in the manner provided for service of a summons and complaint by FRBP 7004, within the time determined under FRBP 9006(d). Whether a type of relief is deemed a contested matter is often specified in the FRBPs related to that specific relief, by reference to FRBP 9014. As an example, lien avoidance motions brought under 11 U.S.C. § 522(f) are contested matters pursuant to FRBP 4003(d).

Other motions: Some matters that are not considered contested matters by reference to FRBP 9014 may still require FRBP 7004 service. The most common example is claim objections, which typically require lesser service, but require FRBP 7004 service if the claimant is the United States or any of its officers or agencies, or an insured depository institution. FRBP 3007(a)(2). FRBP 7004 service in the context of claim objections is discussed further below.

Different service requirements of FRBP 7004(b)(3) and 7004(h):

In addition to more onerous methods described in FRCP 4, FRBP 7004 permits service by mail of adversary proceeding summons and complaints, as well as contested matter motions. But the specific mailing requirements vary depending on the type of entity receiving service. As to most business entities, FRBP 7004(b)(3) permits service within the United States by first-class mail postage prepaid "*to the attention of an officer, a managing or general agent, or to any other agent authorized by appointment or by law to receive service of process and, if the agent is one authorized by statute to receive service and the statute so requires, by also mailing a copy to the defendant*." Also, under FRBP 7004(b)(8), service on any entity or

individual may be accomplished by mailing via first class mail postage prepaid to an agent authorized to receive service of process.

FRBP 7004(h) provides an exception to FRBP 7004(b)'s permissive service by first class mail where the recipient of service is an "insured depository institution," discussed below. Where FRBP 7004(h) is applicable, service by first class mail is not sufficient. Instead, service must be by certified mail addressed to an officer of the institution unless any of three exceptions apply: (1) the institution has appeared by its attorney, in which case the attorney shall be served by first class mail; (2) the court orders otherwise after service upon the institution by certified mail of notice of an application to permit service on the institution by first class mail sent to an officer of the institution designated by the institution; or (3) the institution has waived in writing its entitlement to service by certified mail by designating an officer to receive service. In addition to requiring service by certified mail instead of first-class mail, FRBP 7004(h) differs from FRBP 7004(b)(3) and (b)(8) by generally excluding the possibility of serving the receiving party by serving its registered agent. In re Eimers, No. A12–00692–GS, 2013 WL 1739645, at *2 (Bankr. D. Alaska April 23, 2013) (citing In re Exum, 2013 WL 828293, at *3 (Bankr. E.D.N.C. March 6, 2013)).

Is FRBP 7004(h) service required for credit unions?

FRBP 7004(h) applies where service is being made on an "insured depository institution" as defined in section 3 of the Federal Deposit Insurance Act (the "FDIA"). Section 3 of the FDIA states: "The term 'insured depository institution' means any bank or savings association the deposits of which are insured by the Corporation pursuant to this chapter." 12 U.S.C. § 1813(c)(2). Notably, this definition excludes credit unions. There are then two approaches as to whether FRBP 7004(h) service is required on credit unions. As discussed below, Approach 2 appears to be the right one.

Approach 1—FRBP 7004(h) service is required for credit unions: The Bankruptcy Code defines "insured depository institution" differently than FRBP 7004(h). Under 11 U.S.C. § 101(35), the term "insured depository institution": (A) has the meaning given it in section 3(c)(2) of the FDIA, like under FRBP 7004(h); and (B) includes an "insured credit union," as defined by 11 U.S.C. § 101(34)—which is based on the definition of insured credit unions found in section 101(7) of the Federal Credit Union Act—except in

two circumstances not relevant here. In other words, unlike FRBP 7004(h), § 101(35) does specifically include credit unions in the definition of insured depository institutions. This approach would resolve this conflict in favor of the Code rather than the Rule.

The reasoning is based on the statute implementing the FRBPs, 28 U.S.C. § 2075, which provides that the Rules of Procedure "shall not abridge, enlarge, or modify any substantive right." Therefore, as numerous courts have recognized, any conflict between the Code and the Rules must be settled in favor of the Code. In re Pacific Atlantic Trading Co., 33 F.3d 1064, 1066 (9th Cir. 1994); In re Smart World Techs, LLC, 423 F.3d 166, 181 (2nd Cir. 2005). Furthermore, FRBP 9001 states that the definitions of words and phrases provided in § 101 of the Code, among other sections, govern their use in the FRBPs. This approach contends that FRBP 7004(h) conflicts with § 101(35) in defining "insured depository institution," and that the Code's definition applies, which ultimately includes credit unions as needing service under the requirements of FRBP 7004(h), as opposed to FRBP 7004(b)(3). There are instances where courts took this approach, generally requiring FRBP 7004(h) service on credit unions. *See* In re Drobney, 583 B.R. 700, 702 (Bankr. W.D. Mich. 2018); In re Fisher, 2008 WL 4280388, at *1–2 (Bankr. N.D. Ala. 2008). But those cases lack a discussion about any conflict between the FRBPs and the Code, and seemingly assume that the Code definition applies, leaving out any reference to section 3 of the FDIA.

Approach 2—FRBP 7004(h) service is not generally required for credit unions: This approach adopts the meaning of "insured depository institution" for purposes of FRBP 7004(h) from section 3 of the FDIA, which does not include credit unions. The different definition of insured depository institution found in the Code can be resolved in favor of the Rule for at least a couple reasons. First, consider the canon of statutory interpretation that the specific governs the general. RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639, 645 (2012). While § 101(35) generally includes credit unions within the definition of "insured depository institution," FRBP 7004(h) excludes them from the definition for the specific purpose of service under FRBP 7004. As such, the general/specific canon would suggest that the conflict be resolved in favor of FRBP 7004(h), being the more specific provision when compared to § 101(35). Second, this approach is supported by the fairly unique congressional heritage of FRBP 7004(h). Normally, under 28 U.S.C. § 2075, the Supreme Court transmits new or amended FRBPs to Congress, and the new FRBPs later become

effective, absent congressional intervention. In contrast, FRBP 7004(h) and the first phrase of FRBP 7004(b) ("Except as provided in subdivision (h)") were added by express congressional action in § 114 of the Bankruptcy Reform Act of 1994, Pub.L. No. 103-394, 108 Stat. 4106. That FRBP 7004(h) was affirmatively enacted by Congress weighs against the argument that the definition of insured depository institution found in § 101(35) should override the definition in FRBP 7004(h). Under this approach, credit unions do not generally fall into FRBP 7004(h), as they are not included in the definition of an insured depository institution as defined by section 3 of the FDIA, and service upon them must instead comply with FRBP 7004(b)(3). *See, e.g.*, In re Cornejo, No. A10–00351–DMD, 2010 WL 7892449, at *1 (Bankr. D. Alaska August 2, 2010).

Exception—Claim Objections: Even if taking the second approach above, such that FRBP 7004(h) service is not generally required for credit unions, there is currently a narrow exception when the underlying motion is a claim objection. For claim objections, the manner of service required to the claimant is governed by FRBP 3007(a)(2)(A), which generally permits service by first-class mail to the person most recently designated on the claimant's proof of claim to receive notices, at the address so listed in the proof of claim.

There are two exceptions to that rule, which, when applicable, require *additional* service on top of that generally permitted by FRBP 3007(a)(2)(A). One exception is when the claimant is the United States or any of its officers or agencies, who would require service pursuant to FRBP 7004(b)(4) or (5). FRBP 3007(a)(2)(A)(i). More relevant to this discussion is FRBP 3007(a)(2)(A)(ii), which states, "if the objection is to a claim of an insured depository institution, [then service must be] in the manner provided by Rule 7004(h)." So, like FRBP 7004(h), FRBP 3007(a)(2)(A)(ii) sets a requirement on an "insured depository institution." But unlike FRBP 7004(h), FRBP 3007(a)(2)(A)(ii) does not refer to the definition found in section 3 of the FDIA. Because of that distinction, FRBP 3007(a)(2)(A)(ii) is seemingly using the definition of "insured depository institution" as it exists in the rest of the Bankruptcy Code and FRBPs, which pursuant to § 101(35) does include credit unions.

Therefore, even if service under FRBP 7004(h) is not generally required for credit unions, it does appear to be required where the underlying motion is a claim objection and the claimant is a credit union. At least until December

1, 2021. On October 20, 2020, the Committee on Rules of Practice and Procedure of the Judicial Conference of the United States published a memorandum of rules changes that, absent congressional action, will become effective on December 1, 2021. Among a handful of changes to the FRBPs, is the following:

> Rule 3007 concerns objections to claims. The proposed amendment clarifies that the special service method required by Rule 7004(h) must be used when the claimant is an insured depository institution as defined in section 3 of the Federal Deposit Insurance Act, 12 U.S.C. § 1813. This clarification eliminates the possibility that Rule 3007(a)(2)(A)(ii) would be read to require use of Rule 7004(h)'s special service method when the claimant is a credit union rather than a bank.

Accordingly, on December 1, 2021, credit unions will be excluded from requiring FRBP 7004(h) service under all circumstances, including for claim objections. But for now, in addition to service required by FRBP 3007(a)(2)(A), FRBP 7004(h) service is required on a credit union where a claim objection is directed at its claim.