In re WATSON

JUDITH H. WIZMUR, Bankruptcy Judge.

In this Chapter 7 case, we must determine the validity of cross-collateralization provisions by which the South Jersey Federal Credit Union (“Credit Union”) seeks to collateralize unsecured advances to the debtor with collateral given by the debtor in connection with a secured loan.

FACTS

The debtor, a member of the Credit Union since 1985, was accustomed to borrowing money from the Credit Union on an intermittent basis. The loans were secured only by the debtor’s shares and/or deposits in her credit union accounts. In 2000, the debtor borrowed money from the Credit Union to purchase a vehicle, which also served as collateral for the loan. The debtor challenges the Credit Union’s position that the vehicle collateralizes not only the vehicle loan, but also the debtor’s outstanding debt to the Credit Union on otherwise unsecured advances, taken both before and after the vehicle loan.

We begin with an analysis of the documents executed by the debtor creating the credit arrangements and security agreements between the parties. The Credit Union utilizes the LOANLINER Lending Systems format for the documentation of its loans. The LOANLINER documents are form documents created by CUNA Mutual Group, an insurance and bonding company, and are used by many other credit unions throughout the country. The Credit Union offers to its members an open-end credit plan, utilizing this system. To initiate the open-end plan, the Credit Union member must first sign a LOANLINER Application and Credit Agreement (“Agreement”). This Agreement establishes the legal obligation between the member and the Credit Union. In pertinent part, the LOANLINER Agreement directs the debtor as follows:

IMPORTANT The following is part of your LOANLINER Open-End plan. Read this information before signing on page 4.

....

HOW THIS PLAN WORKS – The credit union anticipates that you will borrow money (called advances) under this Plan from time to time.... The Addendum describes the different types of credit (called subaccounts) available under this Plan....

PROMISES TO PAY – You promise to repay to the credit union all advances made to you under this Plan.... The interest rate depends on the subaccount under which the advance is made....
PAYMENTS – The amount of payments for an advance is determined according to the payment schedule in the Addendum....

SECURITY INTEREST – You agree that all advances under this Plan will be secured by the shares and deposits in all joint and individual accounts you have with the credit union now and in the future. Additional security will be required depending on the subaccount under which an advance is requested.... Property given as security under this Plan or for any other loan may secure all amounts you owe the credit union now and in the future.

In the signature block of the Application and Credit Agreement, the applicant is reminded to “read all the provisions of the credit agreement and addendum thoroughly before you sign,” and agrees, by signing the document, “to be bound by the terms of the agreement.”

The Addendum, a separate document which “is incorporated into and becomes a part of your LOANLINER Credit Agreement,” details the various percentage rates, the calculation of the annual percentage rate (“A.P.R.”) and other related charges associated with the plan. Phil Ritz, Vice President of the Credit Union, certifies that the Addendum, which is modified from time to time to reflect current rates, is routinely supplied to all Credit Union members, along with signed copies of the Application and Credit Agreement, at the time the Agreement is signed. The Credit Union makes its initial Truth-in-Lending disclosures through this document.

Once the agreement has been executed, the member may apply for extensions of credit under the plan. The Credit Union provides for the advancement of monies through various subaccounts. When an advance is made, it is memorialized in a document called the Advance Request Voucher and Security Agreement (“Voucher”). The Credit Union contends that this Voucher, which is for informational purposes to notify the member of the repayment requirements in connection with an advance, “need not contain Truth In Lending disclosures because those disclosures are provided at the time when the Plan is opened through the Credit Agreement and Addendum.” Nevertheless, an updated Addendum reflecting the current rates at the time of the advance is customarily provided at the time the advance is made. The Voucher contains the following language:

You request the following advance subject to the term and conditions of your LOANLINER Credit Agreement.

On the reverse side of the Voucher, under the designation of “Security Agreement,” the document provides:

THE SECURITY FOR THE LOAN – By signing this security agreement in the signature area or under the statement referring to this agreement which is on the back of the check you received for the advance, you give the credit union what is known as a security interest in the property described in the “Security Offered” section....

WHAT THE SECURITY INTEREST COVERS – The security interest secures the advance and any extensions, renewals or refinancing of the advance. It also
secures any other advances you have now or receive in the future under the LOANLINER Credit Agreement, any other loans you have with the credit union, including any credit card loan, and any other amounts you owe the credit union for any reason now or in the future, except any loan secured by your principal residence. If the property description is marked with two stars (* *), or the property is household goods as defined by the Credit Practice Rule, the property will secure only the advance and not other amounts you owe.

In this case, the debtor signed a LOANLINER Application and Credit Agreement with the Credit Union on December 18, 1993. Thereafter, Ms. Watson applied for and was given several unsecured advances, including advances received in 1995, 1997 and 1999, at various interest rates ranging from 11.5% to 16.25%. The last two unsecured advances prior to the filing of the Chapter 13 case were received by the debtor on or about October 20, 2000 and April 30, 2001.

Before the debtor received the last two unsecured advances, the debtor obtained a secured loan from the Credit Union, on October 4, 2000, in the amount of $14,960.00, for the purpose of purchasing a used 1997 Nissan Pathfinder. The debtor executed another Voucher, and was charged interest at 9%. Under Section 3 of this agreement, titled “Security Offered”, the agreement provided that “in addition to the pledge of shares in your loanliner credit agreement, the following property secures the advance:” a 1997 Nissan Pathfinder….

The vehicle loan Voucher contained the same language about “What the Security Interest Covers” on the reverse of the form as the language noted above on the other Vouchers executed, i.e., that the security interest given “also secures any other advances you have now or receive in the future under the LOANLINER Credit Agreement.”

Prior to the filing of her Chapter 7 petition, the debtor made regular payments on account of her unsecured advances and her secured loan separately. When she filed her bankruptcy case on May 10, 2002, she owed $10,431.76 on the secured loan, and $8,702.66 on the unsecured advances.

On June 7, 2002, the Credit Union filed a motion for relief from the automatic stay, contending that the debtor’s failure to maintain post-petition payments pursuant to the cross-collateralization provisions contained in the loan documents between the parties constituted cause for relief under 11 U.S.C. § 362(d)(1). The debtor filed a cross motion seeking to invalidate the cross-collateralization provisions of the parties’ agreements….

On September 6, 2002, the parties executed a reaffirmation agreement, whereby the debtor reaffirmed the debt secured by her vehicle in the amount of $10,431.76. The parties agreed that the value of the vehicle as of the filing of the petition was $13,200. The parties agreed further that “[t]he signing of this reaffirmation agreement does not constitute a waiver of the parties’ position with regard to the cross-collateral language contained in the loan documents which issue is presently being decided by the Bankruptcy Court.”
DISCUSSION

The October 2000 Voucher executed by the debtor in connection with her vehicle loan expressly cross-collateralizes the vehicle loan with pre-existing and future advances. The Voucher provided that the vehicle “secures the advance and any extensions, renewals or refinancing of the advance,” as well as “any other advances you have now or receive in the future …, any other loans you have with the credit union, … and any other amounts you owe the credit union for any reason now or in the future.” The security clause excepts property that is the debtor’s principal residence or where “the property description is marked with two stars (**).” In the case of such a marking, “the property will secure only the advance and not other amounts you owe.” There was no such marking on the vehicle loan Voucher. Ms. Watson, by executing this Voucher, expressly consented to the cross-collateralization between the vehicle loan, the unsecured advances remaining due, and any future advances….

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In asserting that the Credit Union’s cross-collateralization provisions violate the applicable provision of the Uniform Commercial Code, as adopted in New Jersey, the debtor refers the court to an earlier version of N.J.S.A. 12A:9-204. As recognized by the parties, N.J.S.A. 12A:9-204 was amended twice in 2001 by L.2001, c. 117, approved June 26, 2001, and by L.2001, c. 386, approved January 8, 2002, retroactive to July 1, 2001. Public law 2001, chapter 386 took effect immediately upon approval and was applied retroactively to July 1, 2001. N.J.S.A. 12A:9-710. Pursuant to N.J.S.A. 12A:9-702, this amendment “applies to a transaction or lien within its scope, even if the transaction or lien was entered into or created before this chapter takes effect.” For this reason, we will apply the statute as it was amended.4

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The debtor correctly contends herein that the “after-acquired property clause” in either version of N.J.S.A. 12A:9-204 would invalidate the provisions in the LOANLINER Agreement proposing to take a security interest in collateral to be given at a future time. The 1993 agreement between the parties provided that all advances were secured by the debtor’s shares and deposits in all joint and individual accounts held with the Credit Union now and in the future. The agreement further specified that “[a]dditional security will be required depending on the subaccount under which an advance is requested,” and that future acquired “[p]roperty given as security under this Plan or for any other loan may secure all amounts you owe the credit union now and in the future.” Although the debtor was placed on notice that the initial advances were secured by her accounts with the credit union and that additional security would be required depending on the advance, and that future collateral offered as security for another advance “may” secure all of the amounts she owed to the Credit Union, in the past as well as in the future, these clauses, standing alone, do not create a security interest in after-acquired property.

4 As it relates to this decision, the statutory provision at issue, N.J.S.A. 12A:9-204, was not substantively changed by the 2001 amendments. I conclude that the same result is reached under either version of the statute.

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However, our focus here is not on subsection (b), but on subsection (c) of Section 9-204. The UCC Comment to N.J.S.A. 12A:9-204 provides:

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 obligations whatsoever. Determining the obligations secured by collateral is solely a matter of construing the parties’ agreement under applicable law.

UCC Comment to N.J.S.A. 12A:9-204. Subsection (c) therefore expressly validates the opportunity of parties to cross-collateralize past as well as future advances if the security agreement so provides. The vehicle loan Voucher executed by the parties clearly provides for such cross-collateralization. The agreement provides that the vehicle given as security “also secures” all past and future advances taken by the debtor under the LOANLINER Credit Agreement. I conclude that the cross-collateralization provision entered into between the parties does not violate the provisions of N.J.S.A. 12A:9-204, and may be enforced.

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