

SIGNED.



Dated: September 20, 2010

James M. Marlara
JAMES M. MARLAR
Chief Bankruptcy Judge

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

In re:) Chapter 13
TERENCE ANDREW LYON and CHRIS)
MCCARRON LYON,) Case No. 4:09-bk-30568-JMM
Debtors.) **MEMORANDUM DECISION**

This is a contested stay relief proceeding arising from the motion of Pentagon Federal Credit Union ("Pentagon") to allow it to set off Debtors' funds in a deposit account, as of the petition date, against the loan balance owed by the Debtors to Pentagon (ECF No. 36)..

FACTS AND PROCEDURE

The material facts are not in dispute.

Debtors filed a voluntary chapter 7 petition on November 25, 2009; the case was converted to chapter 13 on February 9, 2010.

On the petition date, Debtors had a total of \$18,977.49 in a money market deposit account with Pentagon.

Since 2002, Debtors have had a Pentagon Visa Platinum credit card. In connection with the line of credit loan, Debtors executed and delivered to Pentagon the "Visa Platinum Cardholder Agreement and Disclosure Statement" ("Agreement"). Paragraph 10 of the Agreement contained the following "boilerplate" provision, which was set forth in capital letters and bold type:

1 10. TO PROTECT US IF YOU ARE IN DEFAULT ON ANY CREDIT
2 EXTENDED OR CASH ADVANCED UNDER THIS ACCOUNT, YOU
3 PLEDGE ALL OF YOUR SHARES, DEPOSITS, PAYMENTS, AND
4 DIVIDENDS WHICH MAY BE RECEIVED, WHETHER HELD JOINTLY
5 OR INDIVIDUALLY, UP TO THE AMOUNT OF YOUR OUTSTANDING
6 BALANCE. THIS DOES NOT INCLUDE YOUR INDIVIDUAL
7 RETIREMENT ACCOUNT. WE MAY TAKE ALL THE SHARES
8 NEEDED BY US TO REPAY YOUR CREDIT EXTENSION OR CASH
9 ADVANCE IF IT IS NECESSARY TO TAKE ALL OF YOUR SHARES
10 FOR THE PAYMENT OF THIS ACCOUNT, YOU UNDERSTAND YOUR
11 MEMBERSHIP IN PENTAGON FEDERAL MAY END. COLLATERAL
12 SECURING OTHER LOANS WITH THE CREDIT UNION MAY ALSO
13 SECURE THIS LOAN.

14 Debtors also each signed a separate page entitled "Authorization for Platinum Rewards
15 Credit Card" ("Authorization"), which was date-stamped January 6, 2002. The Authorization
16 contained the following paragraph directly below the signatures:

17 My signature indicates that I'm aware if I use the Pentagon Federal credit card
18 account or authorize its use or do not cancel it within 30 days after the card is
19 received, the Pentagon Federal Agreement provided with the card is binding
20 on me. I AUTHORIZE A SECURITY INTEREST IN THE PENTAGON
21 FEDERAL SHARE ACCOUNT LISTED ABOVE AND ANY OTHER PFCU
22 ACCOUNTS I MAY HAVE UP TO THE AMOUNT OF MY
23 OUTSTANDING BALANCE TO PROTECT PENTAGON FEDERAL IF
24 I DEFAULT ON ANY CREDIT EXTENDED OR CASH ADVANCED
25 UNDER MY CREDIT CARD ACCOUNT(S).

26 There were no specific deposit account numbers listed in the documents.

27 On the petition date, the line of credit was in default. Pentagon filed a proof of claim
28 for \$33,525.99 for the credit card debt, to which Debtors did not object.¹

After Debtors filed for bankruptcy protection, Pentagon placed an "administrative
hold" upon the deposit account. See Citizens Bank of Maryland v. Strumpf, 516 U.S. 16, 19-21
(1995).

On May 20, 2010, Pentagon filed a "Motion for Relief from the Automatic Stay"
("Motion"), seeking authority to complete the setoff of the \$18,977.49 against the debt, claiming a

¹ Pentagon's motion for stay relief asserts that it filed a "secured" proof of claim.
See ¶ 10 at p. 4. While Proof of Claim No. 8 was not designated as a "secured" claim, Pentagon
attached a copy of the Authorization and an account statement. A creditor that has a right to
setoff has a "secured" claim. See In re Calore Exp. Co., 288 F.3d 22, 46 (1st Cir. 2002) ("[A]
claim accompanied by a right of setoff is a 'secured claim' within the meaning of the Bankruptcy
Code, 11 U.S.C. § 506(a)."); 5 Collier on Bankruptcy ¶ 553.06[3][b][4] (15th ed. rev. 2010).

1 contractual right of setoff. It argued that "[t]he Note, Security Agreement, and the bank's continuous
2 possession of the Deposit Account evidence Pentagon Federal Credit Union's valid, enforceable and
3 perfected first-priority lien upon the Deposit Account."

4 Debtors filed a written opposition contending that the alleged security interest was
5 unenforceable because it did not comply with the federal Consumer Credit Protection Act and
6 specifically the Truth in Lending Act ("TILA") contained therein. See 15 U.S.C.A. § 1601 et seq.;
7 Regulation Z, 12 C.F.R.226.12(d).

8 A preliminary hearing was held on September 7, 2010. The parties agreed that the
9 matter had been fully briefed, that no material facts were in controversy, and the only issue was one
10 of law.

11 ISSUE

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13 Whether Pentagon has a valid consensual security interest in Debtors' money market
14 account which would entitle it to set off the Debtors' funds on deposit against the line of credit loan
15 debt.

16 17 LEGAL ANALYSIS

18
19 The right of setoff (also called "offset") allows entities that owe each other money to
20 apply their mutual debts against each other. While the Bankruptcy Code creates no federal right of
21 setoff, § 553(a) generally preserves in bankruptcy the rights of setoff which otherwise exist. In re
22 Bakersfield Westar Ambulance, Inc., 123 F.3d 1243, 1245 (9th Cir. 1997).

23 In bankruptcy, a creditor having setoff rights in regards to prepetition obligations must
24 obtain relief from the automatic stay to complete the process. See 11 U.S.C. § 362(a)(7).

25 The parties agree that if Pentagon has a valid security interest, it has a right to setoff
26 under applicable federal and/or state law, and "cause" would then exist for relief from the automatic
27
28

1 stay pursuant to § 362(d)(1).² See In re Edgins, 36 B.R. 480 (9th Cir. BAP 1984); In re Lough, 163
2 B.R. 586 (Bankr. D. Idaho 1994). Generally, in a hearing on a motion to lift the stay, the court
3 determines whether the creditor's claim to the estate's property is "colorable." Colore Exp. Co., 288
4 F.3d at 35; In re Johnson, 756 F.2d 738, 740 (9th Cir.1985).

5 The court is also mindful that "setoffs in bankruptcy have long been 'generally
6 favored,' a presumption in favor of their enforcement exists." In re De Laurentiis Enter. Group Inc.,
7 963 F.2d 1269, 1277 (9th Cir. 1992) (citation omitted).

8 Debtors contend that they did not consent to the security interest and, under federal
9 consumer protection laws, the security interest is invalid. The parties do not dispute that Pentagon
10 is subject to such laws.

11 Specifically, 15 U.S.C.A. § 1666h of TILA provides:

12 (a) Offset against consumer's funds

13 A card issuer may not take any action to offset a cardholder's
14 indebtedness arising in connection with a consumer credit
15 transaction under the relevant credit card plan against funds of
the cardholder held on deposit with the card issuer unless--

16 (1) such action was previously authorized in writing by the
17 cardholder in accordance with a credit plan whereby the
18 cardholder agrees periodically to pay debts incurred in
19 his open end credit account by permitting the card issuer
periodically to deduct all or a portion of such debt from
the cardholder's deposit account, and

20 (2) such action with respect to any outstanding disputed
21 amount not be taken by the card issuer upon request of
the cardholder.

22 Regulation Z, which implements this section, nevertheless provides that a card issuer
23 may offset a cardholder's indebtedness if it obtains or enforces a consensual security interest in the
24 funds. See 12 C.F.R. § 226.12(d)(2).³

25
26 ² Thus, other than the issue of a consensual security interest, the court need not
27 address the legal basis for Pentagon's setoff right, which has not been challenged.

28 ³ This entire provision states:

(d) Offsets by card issuer prohibited. (continued . . .)

1 The applicable Official Staff Commentary to this section refines the meaning of
2 "consensual" as follows:

3
4 1. Security interest—limitations. In order to qualify for the exception
5 stated in § 226.12(d)(2), a security interest must be affirmatively agreed
6 to by the consumer and must be disclosed in the issuer's initial
7 disclosures under § 226.6. The security interest must not be the
8 functional equivalent of a right of offset; as a result, routinely including
in agreements contract language indicating that consumers are giving
a security interest in any deposit accounts maintained with the issuer
does not result in a security interest that falls within the exception in §
226.12(d)(2). For a security interest to qualify for the exception under
§ 226.12(d)(2) the following conditions must be met:

9 - The consumer must be aware that granting a security interest is
10 a condition for the credit card account (or for more favorable
11 account terms) and must specifically intend to grant a security
interest in a deposit account. Indicia of the consumer's
awareness and intent could include, for example:

- 12 — Separate signature or initials on the agreement indicating
13 that a security interest is being given
- 14 — Placement of the security agreement on a separate page,
15 or otherwise separating the security interest provisions
16 from other contract and disclosure provisions
- 17 — Reference to a specific amount of deposited funds or to
18 a specific deposit account number

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20
21 (1) A card issuer may not take any action, either before or after
22 termination of credit card privileges, to offset a cardholder's
23 indebtedness arising from a consumer credit transaction under the
relevant credit card plan against funds of the cardholder held on
deposit with the card issuer.

24 (2) This paragraph does not alter or affect the right of a
25 card issuer acting under state or federal law to do any of the
26 following with regard to funds of a cardholder held on deposit
with the card issuer if the same procedure is constitutionally
27 available to creditors generally: Obtain or enforce a
consensual security interest in the funds; attach or otherwise
levy upon the funds; or obtain or enforce a court order
28 relating to the funds.

1 - The security interest must be obtainable and enforceable by
2 creditors generally. If other creditors could not obtain a security
3 interest in the consumer's deposit accounts to the same extent as
4 the card issuer, the security interest is prohibited by §
5 226.12(d)(2).

6 52 FR 10875-02 (April 6, 1987).

7 Debtors raise two main problems with the security interest in this case. First, they
8 maintain that the boilerplate terms fall short of the requirements for a security interest and merely
9 acknowledge the general statutory lien rights of the credit union. See 12 U.S.C.A. § 1757(11).

10 They cite the case of In re Clark, 161 B.R. 290 (Bank. N.D. Fla. 1993), which also
11 involved a motion for stay relief by a federal credit union to permit it to set off the debtors'
12 indebtedness under a Visa credit card account against funds on deposit with the credit union. That
13 is where the factual similarity ends.

14 The credit card agreement signed by the Clark debtors provided as follows:

15 I understand and agree that the credit union has the authority to
16 impress and enforce a lien on all present and future shares in my name
17 to the extent of that portion of the loan balance which may be in
18 default, including costs of collection and reasonable attorney's fees.

19 161 B.R.at 292.

20 The bankruptcy court held that this language was not a grant of a security interest but
21 rather an acknowledgment of the credit union's statutory lien rights, which the TILA regulations
22 make clear is not the type of "the security interest" contemplated.

23 In contrast to the language in Clark, Paragraph 10 of Pentagon's Agreement contains
24 an express "pledge" of the cardholders' "deposits." The Authorization further expressly states that
25 the cardholders "authorize a security interest." This court has no difficulty finding that the language
26 in Pentagon's agreement, even though boilerplate, meets the requirements of TILA.

27 Debtors' second argument is related to the form of the security interest provisions
28 which, they maintain, do not contain "the indicia of the Debtors' awareness and intent to enter into
29 a consensual security agreement." Debtors' Objection to Motion, p. 5. Debtors contend that: (1)
30 the language granting a security interest is not on a separate page; (2) the provisions do not reference
31 by name or account number any specific deposit account held by Debtors; and (3) the signatures

1 appear to be general in nature for the use of the card and not specifically for granting a security
2 interest. These arguments are without merit.

3 The Official Staff Commentary states that the security interest provisions should be
4 placed on a separate page, or otherwise separated from other contract and disclosure provisions.
5 Paragraph 10, while imbedded in the other contract terms, is purposefully enlarged and boldfaced
6 to stand out from the other terms. Indeed, the security interest provision on the Authorization page
7 is on a separate page from other contract and disclosure provisions.

8 Debtors suggest, in a footnote, that it is unclear whether the Authorization is part of
9 the same document. This comment actually proves the point, i.e., that a separate page was used,
10 while failing to prove that two agreements were executed, because no evidence was presented that
11 Debtors entered into two different Visa credit card agreements with Pentagon on the date in
12 question.

13 Next, according to the Official Staff Commentary, there should be a reference to a
14 specific amount of deposited funds or to a specific deposit account number. Paragraph 10
15 specifically states that Debtors are pledging "all of" their shares and deposits. The Authorization
16 provides a security interest "in the Pentagon Federal share account listed above and any other PFCU
17 accounts I may have." The language specifically references any and all of Debtors' accounts with
18 Pentagon.

19 Finally, there should be a separate signature or initials on the agreement indicating that
20 a security interest is being given. Debtors signed the Authorization directly above the terms by
21 which they were agreeing to grant Pentagon a security interest. The security interest terms provide
22 that Debtors' "signature[s]" indicate they are "aware" that they are bound by the Agreement. The
23 signatures and context speak for themselves. In addition, all such terms are in capital letters and bold
24 type, designed to stand out from the other contract terms. Compare In re Okigbo, 2009 WL
25 5227844, at * 4 (Bankr. D. Md. 2009) (terms in fine print meant to create a security interest
26 contained "none of the bells and whistles required so as to focus Debtor's attention on it.")

27 Based on the foregoing analysis, the court concludes that the Agreement meets the
28 requirements for a consensual security interest under TILA and Regulation Z.

1 CONCLUSION

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3 By separate Order, the automatic stay shall be lifted to allow Pentagon to set off
4 the balance in Debtors' money market account against the loan balance.

5
6 DATED AND SIGNED ABOVE.

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8 COPIES to be sent by the Bankruptcy Notification Center ("BNC") to the following:

9 John N. Skiba, Attorney for Debtors

10 Lisa S. Kass, Attorney for Pentagon Federal Credit Union

11 Dianne C. Kerns, Trustee

12 Office of the United States Trustee