



**IT IS HEREBY ADJUDGED and DECREED that the below described is SO ORDERED.**

**Dated: October 27, 2004**

**ROBERT E. NUGENT  
UNITED STATES BANKRUPTCY JUDGE**

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

<b>IN RE:</b>	)	
	)	
<b>KRISTI LYNN CHRISTY,</b>	)	<b>Case No. 04-10987</b>
	)	<b>Chapter 13</b>
<b>Debtor.</b>	)	
_____	)	
	)	
<b>FIRST CHOICE CREDIT UNION,</b>	)	
	)	
<b>Plaintiff,</b>	)	
<b>v.</b>	)	<b>Adversary No. 04-5176</b>
	)	
<b>KRISTI LYNN CHRISTY,</b>	)	
	)	
<b>Defendant.</b>	)	
_____	)	

**MEMORANDUM OPINION**

On September 14, 2004, a number of matters in controversy in the above captioned bankruptcy

case came before the Court for evidentiary hearing.<sup>1</sup> At issue were: (1) Debtor's Motion to Determine Value of Security (Dkt. 27); (2) First Choice Credit Union's Motion for Relief from the Stay (Dkt. 8); (3) confirmation of the debtor's chapter 13 plan (Dkt. 32); and (4) Debtor's Objection to First Choice Credit Union's proofs of claim numbers 1 and 5 (Dkt. 29 and 48). The Court heard evidence and received several documentary exhibits. Having reviewed the record before it, the Court is ready to rule.

### Jurisdiction

The matters in controversy arise in a case under Title 11 of the United States Code and are core proceedings over which this Court has jurisdiction pursuant to 28 U.S.C. § 1334(a) and § 157(b)(1) and (b)(2)(B), (G), (K), and (L).

### Factual Background

The debtor Kristi Christy ("Christy") has had a credit relationship with First Choice Credit Union ("FCCU") since the 1990's. In April of 1997, she began to use a FCCU-issued credit card. On September 13, 2000, Christy borrowed \$4,840.04, repayment of which was secured by a 1997 Jayco travel trailer (the "Trailer Loan"). On August 8, 2001, she borrowed \$10,085.92 which was secured by a 1997 Honda Civic (the "Honda Loan"). Finally, on January 27, 2003, she borrowed \$14,000

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<sup>1</sup> Two additional matters arise out of First Choice Credit Union's Complaint to Determine Dischargeability filed in the adversary proceeding. First Choice seeks to except from discharge that portion of Christy's debt arising from a trailer it financed and which Christy allegedly sold in violation of 11 U.S.C. § 523(a)(4) and (a)(6). Debtor filed a motion to dismiss the § 523(a)(4) and (a)(6) claims and asserted a counterclaim requesting the release of First Choice's lien in the trailer (which Debtor contends she paid for) and a determination that any cross-collateralization under First Choice's loan documents should be declared invalid. The motion to dismiss was argued on September 14, 2004 and granted from the bench. A separate order memorializing that ruling was to be submitted by counsel for entry on the docket of that matter. The remaining issues in the adversary proceeding are subsumed in the disputes pending in the main case and will be decided in accordance with this Memorandum Opinion.

which was secured by a 1997 Toyota 4Runner (the “Toyota Loan”). All three of these loans are memorialized on form documents entitled “Closed End Note, Disclosure, Loan and Security Agreement,” and, with one material variation discussed later, all three document forms are identical.

The parties also offered into evidence a Visa Credit Card Agreement and Grace Agreement (“Credit Card Agreement”) dated April 4, 1997. The document as admitted contains a signature purporting to be Christy’s, but she denies having signed it, asserting that she applied for the credit card over the telephone and that a FCCU employee must have signed the agreement for her. Christy does not deny using the card or signing numerous credit card receipts and she acknowledges the credit card debt as her own.

According to FCCU’s proof of claim, as amended, Christy is indebted to FCCU in the aggregate amount of \$24,223.05.<sup>2</sup> As of June 9, 2004, the remaining balance due on the Honda Loan is \$3,520.63 and the balance due on the Toyota Loan is \$10,008.41. The remainder of the debt is attributable to the credit card.

The principle issue in this case is the meaning and effectiveness of the future advance clause in each of the four transaction documents, namely, whether all of Christy’s obligations are cross-collateralized by all of FCCU’s collateral. Christy asserts that, because she has paid in full the Trailer Loan, the lien on the trailer (which she no longer has) should be released. She seeks to cram down the Honda Loan and Toyota Loan to the respective market value of each vehicle and, most importantly, she denies that any of the collateral she has pledged to FCCU secures the repayment of her credit card debt, arguing that this debt is not sufficiently “related” to the vehicle loans and that the parties did not intend that the credit card obligation and the car loans be tied together.

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<sup>2</sup> See Proof of Claim No. 5.

Christy filed this case as a Chapter 7 on March 5, 2004. She converted her case to Chapter 13 on June 10, 2004 and filed a plan on June 29, 2004.<sup>3</sup> In her Chapter 13 plan, Christy sought to cram down FCCU's secured claim to \$8,900, \$3,200 with respect to her 1997 Honda Civic and \$5,700 with respect to her 1997 Toyota 4Runner. FCCU objected to confirmation of her plan and sought stay relief to proceed against its collateral. FCCU disputes the valuation of the vehicles and asserts that, because Christy sold the trailer and because her schedules are internally inconsistent, the plan is not proposed in good faith.

In October of 2003, Christy sold the trailer for about \$4,000 to one Dewey Hostetler who, in turn, gave the trailer to his son. Hostetler's son transported the trailer to Colorado where it is believed to be currently located. Christy obtained no lien release from FCCU. Prior to selling the trailer, Christy checked her outstanding loan balances on the credit union website and determined that she only owed \$499 on the Trailer Loan. When she sold the trailer, Christy deposited the proceeds of sale in an account at Fidelity Bank and sent FCCU a check for \$828 to pay off the Trailer Loan and make regular payments on the other vehicle loans. According to the transaction report on the Account History page submitted in evidence, FCCU applied some \$127 to the Trailer Loan and \$325.30 to the Toyota Loan on November 3, 2003. Thereafter, on December 12, FCCU credited Christy with another loan payment on the trailer, this one leaving \$9.61 due and owing. On December 12, FCCU debited Christy's credit union checking account for this amount and the Trailer Loan was paid in full. According to Christy, she spent the balance of the trailer proceeds on a new furnace and some dental work. While the documents do not precisely track Christy's recollection of the transactions concerning the trailer, neither she nor FCCU's president, Linda Nicholson, could explain the

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<sup>3</sup> Dkt. 32.

differences and the fact remains that the Trailer Loan was paid in full.

Christy also stated that she “forgot” she had a trailer title and, consequently, did not think of securing a lien release for the trailer from the credit union. Only when she was requested to supply a title to Hostetler did she discover the need for a release. FCCU claims that it retains a security interest in the trailer to secure the remainder of her debt and has declined to give the release to Christy.

Each party presented valuation evidence of varying weight. Christy supported her proposed values of \$3,200 for the ‘97 Honda and \$5,700 for the ‘97 Toyota with the testimony of Bud Palmer, a longtime auctioneer in the Wichita area. Mr. Palmer testified that he sells many different kinds of cars at his auction, that he had viewed these vehicles, and that he has sold vehicles similar to them. His opinion of the value of the Honda lay in a range of \$3,200 to \$3,400, owing to its high mileage (80,000-90,000), cracked windshield, and paint damage. He characterized the Toyota as a “nice car” with 86,000 miles and a leather interior. He considered it to be in average condition and he valued it between \$5,500 and \$9,000.

FCCU, on the other hand, presented a printout from the NADA guide<sup>4</sup> which valued a 1997 Toyota 4Runner “Limited” (the highest trim level) at an average retail of \$13,375. Ms. Nicholson testified that she had viewed the 4Runner through the drive-through window at the credit union and that it appeared to be in good condition.<sup>5</sup>

The Court gives more credence to Mr. Palmer’s live testimony which is based on his actually

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<sup>4</sup> <http://www2.nadaguides.com/uv>, September 13, 2004, see Ex. 1.

<sup>5</sup> The Court is troubled by the quality of the valuation evidence in this case, especially when the Chapter 13 Trustee maintains relationships with competent automotive appraisers whose services are available to all debtors and creditors for a modest fee. Use of this readily accessible and reliable resource is strongly encouraged.

viewing the cars. It is likely that the 4Runner would bring \$9,000 at his auction. Accordingly, the Court finds that the value of the 4Runner for confirmation purposes is \$9,000. FCCU presented no valuation evidence concerning the Honda. The Court finds that Mr. Palmer's appraisal of \$3,200 is credible and fixes the Honda's value at that amount for confirmation purposes.

The only evidence in the record concerning the trailer's value is that Christy received \$4,000 for it. Because FCCU's lien was never released, and because Christy has never transferred record title to the trailer, it remains property of her bankruptcy estate, subject, of course, to the claims of the purchaser and the lien holder. Adding this amount to the value of the 4Runner (\$9,000) and the Honda (\$3,200), FCCU's collateral has an aggregate value of \$16,200.

According to FCCU, all of its collateral secures the repayment of all its remaining debt, which, including the credit card obligations, amounts to some \$24,223.05. Christy contends that because the various notes and the credit card obligation are not cross-collateralized, the remaining collateral only secures the repayment of the Honda Loan and the Toyota Loan. Those balances total \$13,529.04, leaving some equity in the collateral for the benefit of the estate. If FCCU's position is correct, that equity would secure repayment of not only the vehicle notes, but also of some of the credit card debt.

### Analysis

Determining whether these obligations are cross-collateralized requires an examination of the terms of the parties' agreements and a review of the current state of the law concerning future advances and after-acquired property clauses in transactions governed by Article Nine of the Kansas Uniform Commercial Code ("UCC").

The Trailer, Toyota, and Honda Loan documents are similar, but not identical, to one another. Each is a "Closed End Note, Disclosure, Loan and Security Agreement." The Trailer and Honda Loan

documents appear on a form bearing the revision date “2/99” while the Toyota Loan document appears on a form bearing a revision date of “4/01.”<sup>6</sup> The only material difference in the preprinted forms is found on the reverse page containing the Security Agreement terms. In the earlier form, at paragraph 1 of the Security Agreement, the following language appears:

Cross-collateralization: Property given as security for this loan or for any other loan will secure all accounts I owe the credit union now and in the future, *including all debts incurred by credit card.*<sup>7</sup>

The Toyota Loan note form contains similar language, but omits a direct reference to credit card debt.<sup>8</sup>

On the face of each note form is a “federal box,” the area where Truth in Lending disclosures are made. Within the federal box is the statement “Collateral for other loans will also secure this loan.” On the Trailer Loan note form, the box describing the trailer as collateral is checked. On the Honda Loan note form, the box describing the Honda as collateral is checked. On the Toyota Loan note form, however, none of the collateral boxes are checked, although the Toyota is described in the “Security Information” area located just below the federal box.

The granting clause of the Security Agreement is found on the reverse of each note form and states as follows:

To secure payment of this loan and all expenditures incurred by the credit union in connection with this loan, or in realizing on a security interest, I [borrower] grant to you [credit union] a security interest *in the property described on page 1 of this document.*<sup>9</sup>

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<sup>6</sup> The parties did not supply the Court with a “reverse” side of the Trailer Loan document, but stipulate that its reverse is identical to the reverse of the Honda Loan document. See Exhibit A, pp. 3-5.

<sup>7</sup> Ex. A, p. 5 (emphasis added).

<sup>8</sup> Ex. A, p. 7.

<sup>9</sup> Ex. A, p. 5 and p. 7 (emphasis added).

Based on the granting clause, the Court concludes that the omission of a check mark in the collateral box on the Toyota Loan note is not fatal to the credit union's security interest in the Toyota. It was clearly the intention of the parties that a security interest be granted in the Toyota and the security agreement meets the requirements of KAN. STAT. ANN. § 84-9-203(b) (2003 Supp.). A signed security agreement describing the Toyota is present, the FCCU gave value, and Christy has rights in the collateral.

The other important document in this matter is the Visa Credit Card Agreement, the signing of which Christy denies. Presumably, Christy considers this important because the credit card agreement also contains a security agreement clause pursuant to which debtor grants a security interest to the credit union in all items purchased with the credit card as well as being "secured by any security interest granted to the credit union under any loan plan with the Credit Union. . . ." <sup>10</sup> Arguably, in the absence of a specific reference in the credit card agreement to collateral given for other loans, the credit card indebtedness would not be secured by that other collateral. Until the enactment of Revised Article 9 by the Kansas Legislature in 2001, that would likely have been the case. <sup>11</sup>

The enactment of KAN. STAT. ANN. § 84-9-204 in 2001 prompts the question whether Kansas law has changed with respect to cross-collateralization and the impact of dragnet and future advance clauses. For many years, in many jurisdictions, courts regularly concluded that the effect of former UCC § 9-204 was limited. That section read, in pertinent part:

(1) . . . [A] security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral.

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<sup>10</sup> Ex. A, p. 12.

<sup>11</sup> The effective date of Revised Article 9 in Kansas was July 1, 2001. *See* KAN. STAT. ANN. § 84-9-701 (2003 Supp.), Revisor's Note.

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(3) Obligations covered by a security agreement may include future advance clauses or other value . . . .<sup>12</sup>

Numerous courts, including those sitting in Kansas, criticized the trend toward blanket approval of dragnet clauses. While the Kansas appellate courts do not appear to have addressed this issue in connection with a personal property security interest, the Kansas Supreme Court held in the 1974 case of *Emporia State Bank v. Mounkes*<sup>13</sup> that a dragnet clause in a purchase money mortgage did not secure a subsequent loan made to enable the homeowner's son in starting up a different business. That court held that when construction of a mortgage is in issue, "the primary question for determination is what was the intention of the parties" and that mortgages "ought never to be so extended as to secure debts which the debtor did not contemplate."<sup>14</sup> The second loan in *Mounkes* was made 8 years later and was denominated a "signature" obligation, implying that the credit extended was to be unsecured. The court manifested the traditional distaste for dragnet enforcement in stating that "the dragnet syndrome is not a stranger in banking circles," but it is not a "favorite of the law" and that such clauses are always subject to interpretation.<sup>15</sup> The court then restated the rule that mortgages must be construed with a view toward the parties intentions and that the security offered in the previous transaction will not be extended to subsequently incurred debt unless the debt is of the same class and is so related to the primary debt that the assent of the note maker is inferred. Absent evidence of a contrary intention on the part of both parties, a dragnet mortgage clause will not be extended to cover future advances unless the advances are of the same kind and quality as the initial loan or the note

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<sup>12</sup> KAN. STAT. ANN. § 84-9-204 (1996).

<sup>13</sup> 214 Kan. 178, 519 P.2d 618 (1974).

<sup>14</sup> *Id.* at 181.

<sup>15</sup> *Id.* at 180-81.

specifically references the mortgage.<sup>16</sup> Ultimately, the court stated that for a mortgage to be bound as security for a debt other than that for which it was originally given, subsequent notes must specifically reference the mortgage.

In 1982, the Kansas Supreme Court reviewed and refined its view of after-acquired property clauses in *First National Bank & Trust Co. v. Lygrisse*.<sup>17</sup> In *Lygrisse*, the lender made a series of notes, the first of which was secured by a \$400,000 mortgage with a future advance clause. Subsequent notes referenced the original mortgage. Reversing a decision by the Kansas Court of Appeals that *Mounkes* established a rebuttable presumption that the maker did not intend the mortgage to secure a future advance,<sup>18</sup> the court held that antecedent debt is only secured by a subsequent mortgage when the debt is clearly identified in the mortgage.<sup>19</sup> In addition, the court clarified that the intent of the parties always governs and that subsequent obligations are secured by prior mortgages when the new notes reference the mortgage or there is a showing that the subsequent obligation is of the same kind and character as the former debt or is part of the same transaction.<sup>20</sup>

In his 1996 commentary to the Kansas UCC, Professor Barkley Clark noted:

Although the *Mounkes* decision involved the homestead rather than personal property under Article 9, the principle seems broad enough to limit dragnet clauses covering personal property, unless they are drafted with great care so that future advances appear to have been in the original contemplation of lender and debtor. . . . Of course if the debtor is a commercial entity rather than a consumer, the courts might well give a broader reading of a dragnet clause . . . .<sup>21</sup>

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<sup>16</sup> *Id.* at 184.

<sup>17</sup> 231 Kan. 595, 647 P.2d 1268 (1982).

<sup>18</sup> 7 Kan. App. 2d 291, 640 P.2d 1274 (1982).

<sup>19</sup> 231 Kan. at 602.

<sup>20</sup> *Id.* at 599.

<sup>21</sup> KAN. STAT. ANN. § 84-9-204 (Furse 1996), Kansas Comment, 1996, Subsection (3).

This interpretation is consistent with the views expressed by other judges and commentators on this point. In addition, as pointed out by Christy, several bankruptcy courts have concluded that where the subsequent borrowings sought to be secured by previous collateral are of a different nature or class, clear reference to the prior liens must be made in order to tie these prior liens to subsequent loans.<sup>22</sup> This appears to be the traditional view of the law, particularly where consumers are concerned.

With the enactment of revised § 9-204, however, this restrictive judicial gloss on the operation of dragnet clauses is open to question for several reasons.<sup>23</sup> First, the Kansas Legislature is presumed to have been aware of the existence of *Mounkes* and the other Kansas cases which significantly limited the operation of the former section.<sup>24</sup> Yet, the current version of this section reads as follows:

(c) Future advances and other value. A security agreement may provide that collateral secures . . . future advances or other value . . . .<sup>25</sup>

While there is, as yet, no Kansas Comment, the Official UCC Comment authored by the National Conference of Commissioners on Uniform State Laws and The American Law Institute forcefully and directly addresses the effect of this new section on previous case law:

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 . . . was of the same or a similar type or class as earlier advances and

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<sup>22</sup> See e.g., *In re Fassinger*, 246 B.R. 513, 520-21 (Bankr. W.D. Pa. 2000) (dragnet clause enforced only if it satisfies the relatedness rule); *In re Kim*, 256 B.R. 793, 797 (Bankr. S.D. Cal. 2000) (applying "relationship of loans" test to car loan and credit card debt); *In re Wollin*, 249 B.R. 555, 560 (Bankr. D. Or. 2000) (same standards applied to antecedent debt requiring specific reference to antecedent debt in dragnet clause).

<sup>23</sup> Under Revised Article Nine's transition rules, revised section 9-204 would generally apply to a security agreement entered into before the July 1, 2001 effective date. See KAN. STAT. ANN. § 84-9-702(a) (2003 Supp.); *In re Watson*, 286 B.R. 594, 601 (Bankr. D. N.J. 2002).

<sup>24</sup> It is presumed that the legislature acted with full knowledge of prior law and conditions that existed under the prior law. *In re Ray*, 26 B.R. 534 (Bankr. D. Kan. 1983).

<sup>25</sup> KAN. STAT. ANN. § 84-9-204(c) (2003 Supp.).

obligations secured by the collateral.<sup>26</sup>

In the 2004 edition of his treatise, Professor Barkley Clark notes that prior to the enactment of the revision, “courts bent over backwards” to protect consumers from the effects of future advance clauses, but that the Comment suggests that, under the revised Code, if the language of the security agreement is broad enough, the clause should be upheld so long as no other statute expressly prohibits it.<sup>27</sup>

At least one other bankruptcy court agrees. In *In re Watson*, a credit union’s Loanliner credit agreement providing that property given as security for any loan secured other advances made to a consumer (except those forbidden by the Truth-in-Lending laws), including credit card charges, was enforceable.<sup>28</sup> The debtor has not raised any Truth-in-Lending concerns here and this Court is unaware of any other statutory bar to the cross-collateralization of antecedent debt or future advances with present collateral.

Here, it appears that under either the old case law formulation or the revised § 9-204(c), the clear language of the security agreement portion of the documents indicates an intent between the parties that the vehicles be pledged not only against repayment of the purchase money obligations from which they arose, but also any other obligations to the credit union, except those expressly excluded in the agreement. Two of the three security agreements expressly reference the credit card indebtedness and the third references “all accounts” owed the credit union. Applying the *Lygrisse* rule, the intent of the parties is clearly expressed and the antecedent debt to be secured is clearly

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<sup>26</sup> 3 UNIFORM LAWS ANN., § 9-204, Official UCC Comment, ¶ 5.

<sup>27</sup> Barkley Clark, 2 THE LAW OF SECURED TRANSACTIONS, ¶ 10.01[4][f] (Rev. ed. 2004).

<sup>28</sup> 286 B.R. 594 (Bankr. D. N.J. 2002). *See also, In re Conte*, 206 F.3d 536 (5th Cir. 2000) (Under former Texas U.C.C. § 9-204, the clear language of the Loanliner documents brought subsequent unsecured advances under security agreement encumbering car).

identified in two of the three security agreements. On the face of each note appeared a clearly delineated statement that all collateral would secure all of Christy's debts to the credit union. The presence of this statement in three documents signed by her is persuasive evidence of her intention that each of these security agreements would secure all of her debt to the credit union. The Court believes this finding would have been sufficient under the old law to extend the security offered in these security agreements to the credit card obligation.

As the Official Comment to new § 9-204(c) unequivocally states, the drafters of Revised Article Nine clearly intended its language to countermand the "same kind and character" and "close relatedness" tests implied by courts into the Uniform Commercial Code from real estate cases like *Mounkes* and *Lygrisse*. In the absence of any statute or case law under Revised Article 9 to the contrary, this Court must conclude that the dragnet clauses questioned here are effective and enforceable.

As stated in the debtor's papers, if the Court finds either that the value of the collateral exceeds that which the plan proposed to repay or that the car loans and credit card debt are secured by whatever equity remains in the vehicles, the plan as offered cannot be confirmed. Having made both findings, the Court finds that the debtor has failed to meet her burden to prove that the plan as offered complies with the provisions of 11 U.S.C. § 1322 and § 1325 and DENIES confirmation. Debtor is allowed 15 days from the date of this order to file an amended plan. If an amended plan is not filed, or if one is filed but not confirmed, the Court may, upon submission of the appropriate order, grant FCCU's motion for stay relief. FCCU's secured claim is allowed in the amount of \$16,200 and debtor's objection to that claim is OVERRULED. FCCU's secured status is as set forth above.

IT IS SO ORDERED.

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