

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TENNESSEE

In re

LESLIE MARIE GREEN,

Debtor.

No. 02-23993
Chapter 13

M E M O R A N D U M

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MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE

The issue presented in this chapter 13 case is whether the debtor's claimed exemption in her credit union account is valid and as such, provides a defense to the credit union's motion for relief from stay to pursue its security interest in the account. For the reasons discussed below, the court concludes that regardless of the validity of the exemption, the credit union is entitled to relief from the automatic stay. This is a core proceeding. See 28 U.S.C. § 157(b)(2)(A),(B),(G) and (K).

I.

The debtor Leslie Marie Green filed for bankruptcy relief under chapter 13 on November 26, 2002. In Schedule B - Personal Property, the debtor listed \$100 in a checking account at Knoxville TVA Employees Credit Union ("KTVA") and in Schedule C - Property Claimed As Exempt, similarly listed this same \$100 as exempt under TENN. CODE ANN. § 26-2-103. In Schedule F - Creditors Holding Unsecured Nonpriority Claims, the debtor scheduled KTVA in the amount of \$1,000 arising out of a line of credit.

Subsequently on December 12, 2002, KTVA filed a motion to modify automatic stay stating that as of the date of the debtor's bankruptcy filing, she had \$2,231.61 on deposit with KTVA and owed KTVA two debts totaling \$2,696.99. KTVA asserted in its motion that "the funds on deposit are subject to a right

of setoff with respect to the indebtedness owed to Movant by the Debtor" and requested "that the automatic stay of 11 U.S.C. § 362 be modified to permit Movant to exercise its right of setoff." The debtor objected to the motion, contending that the funds on deposit were her wages and thus exempt under TENN. CODE ANN. § 26-2-106, and "that these funds were to be used to fund her Chapter 13 bankruptcy and to provide the support of her family." The debtor also amended her Schedules B and C to indicate that her account at KTVA contained \$2,231.61 and to exempt this entire amount pursuant to TENN. CODE ANN. § 26-2-103. Thereafter, KTVA timely objected to the debtor's amended exemption claim on three grounds: (1) "[t]he account is subject to a right of setoff and rights of setoff are treated as secured claims"; (2) "the Debtor has contractually pledged the account to the Credit Union, creating a secured claim"; and (3) "[o]nly equity in collateral subject to a security interest is entitled to be exempt."

Although KTVA's motion was initially denied on procedural grounds, the court subsequently granted KTVA's motion to reconsider, with the merits of the automatic stay relief request to be considered in conjunction with the court's consideration of the debtor's exemption claim and KTVA's objection thereto. The parties agreed that there was no dispute of fact and that

the issues could be decided by the court upon stipulations and memoranda of law, with the automatic stay to remain in effect pending the court's ruling.

The parties have stipulated that the "Debtor became a member of KTVA on April 4, 1986, by signing a General Agreement and Signature Card ... and opening a regular Share Account," which "is equivalent to a savings account at a bank." The "Debtor later opened a Share Draft Account ... on October 19, 1992, by executing a Share Draft Account and Money Belt Card Application," which account "is the equivalent to a checking account at a bank." "The total balance in the Accounts at the time of the Debtor's bankruptcy filing was \$2,233.66."

The parties also stipulated that on August 20, 1993, the "Debtor executed a Loanliner Credit Agreement (the "Loanliner"), ... the master agreement which applies to all loans made by a credit union member," and "obtained a line of credit pursuant to an advance voucher issued under the Loanliner." "At the time of the Debtor's bankruptcy filing, the loan balance on this line of credit was \$1,002.92." The Loanliner includes the following provision:

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....

Additionally, the parties stipulated that the "Debtor also

applied for and received a credit card account with KTVA," and that "the credit card account balance was \$1,686.10" as of the debtor's bankruptcy filing. The credit card terms which accompanied the application provide in pertinent part that:

Cardholder's obligations to the Knoxville TVA Employees Credit Union arising from use of the Card or Related Cards shall be secured by any individual or joint account which Cardholder now has or may in the future have with the Knoxville TVA Employees Credit Union.

While not stipulated, the court notes that the debtor's chapter 13 plan, which was confirmed on April 8, 2003, makes no specific reference to KTVA. The plan does provide, however, the following:

If no secured plan treatment is provided herein, the claim will be treated as unsecured and depending on the allowed claims will be paid the resulting dividend within the following range; provided, however, that if the funds available exceed the specified dividend range creditors will be entitled to the greater dividend ... [of] 5%-20%.

II.

In its memorandum of law, KTVA raises several arguments as to why the debtor's exemption claim should be denied and relief from the stay granted in its favor. First, KTVA contends that under the authority of *In re Lawrence*, 219 B.R. 786 (E.D. Tenn. 1998), *inter alia*, TENN. CODE ANN. § 26-2-106 entitled "Maximum amount of disposable earnings exempt from garnishment" does not

create an exemption for wages applicable to bankruptcy proceedings. Second, KTVA asserts that to the extent the debtor is claiming an exemption under TENN. CODE ANN. § 26-2-103, which allows an exemption in personal property up to the aggregate amount of \$4,000, the debtor's list of claimed exemptions totals \$5,481.61 and thus exceeds the permissible \$4,000 amount. Also with respect to § 26-2-103, KTVA maintains that this exemption, by its specific language, is limited to an individual's equity interest and that the debtor has no equity in her credit union account because the amount owed to KTVA exceeds the balance in the two accounts. KTVA asserts that it has both a perfected contractual security interest in the accounts and a statutory lien under TENN. CODE ANN. § 45-4-609 and that this security interest and lien may not be avoided by the debtor in her bankruptcy proceeding.

Assuming for the moment that the debtor's exemption claim is valid, it is clear that if KTVA's stay relief motion were based solely on its common law right of setoff, denial of the motion would be appropriate. As this court has previously noted, "[i]t is the common law in Tennessee that a creditor may not offset its claim against exempt property." *In re Bourne*, 262 B.R. 745, 753 n.2 (Bankr. E.D. Tenn. 2001)(citing *Commerce Union Bank v. Haffner (In re Haffner)*, 12 B.R. 371, 372 (Bankr.

M.D. Tenn. 1981)(offset denied in exempt certificate of deposit); *Gregg v. New Careville Coal Co.*, 161 Tenn. 350, 31 S.W.2d 693 (1930)(employer prohibited from offsetting claim against exempt workers compensation award); *Collier v. Murphy*, 90 Tenn. 300, 16 S.W. 465 (1891)(exempt wages not subject to setoff by employer)). In apparent recognition of this legal principle, KTVA does not argue a right to setoff in its memorandum of law, even though it was raised in its motion, choosing instead to seek stay relief based on the alleged invalidity of the exemption and a claimed security interest in the debtor's accounts.

The debtor has not challenged KTVA's assertion of a security interest. Both the Loanliner Agreement signed by the debtor and the credit card application appear to grant KTVA a security interest in any accounts of the debtor to secure any obligation of the debtor to the credit union. In *Riggsby v. Fort Oglethorpe State Bank (In re Riggsby)*, Judge Ralph Kelley recognized that "a bank can have a security interest in a deposit pledged for security and in the bank's control." *In re Riggsby*, 34 B.R. 440, 441 (Bankr. E.D. Tenn. 1983). The court concluded, however, that "[a]s to a checking account, ... the reservation of a security interest in the account or items deposited to the accounts amounts to no more than the right of

setoff in a verbal disguise." *Id.* (citing *Cissell v. First National Bank*, 476 F. Supp. 474, 490-491 (S.D. Ohio 1979); *Kenney's Franchise Corp. v. Central Fidelity Bank*, 12 B.R. 390 (Bankr. W.D. Va. 1981); *Duncan v. First Heritage Bank*, 10 B.R. 13 (Bankr. E.D. Tenn. 1980); *Duncan Box & Lumber Co. v. Applied Energies, Inc.*, 270 S.E.2d 140 (W. Va. 1980)). Accordingly, the *Riggsby* court held that the debtor was permitted to exempt and recover monies in the debtor's bank account which the bank had offset against the debtor's indebtedness to the bank. *Id.*

Similarly, in *In re Laues*, the debtors filed a motion requesting that a credit union be required to turnover to the debtors \$430 representing wages which had been directly deposited by the husband's employer into the debtors' credit union checking account. *In re Laues*, 90 B.R. 158, 159 (Bankr. E.D.N.C. 1988). Although the debtors therein had claimed the monies exempt, the credit union objected to the turnover request because the debtors were indebted to the credit union and the loan agreement provided that the debtors "pledge as security ... all present and future shares and/or deposits in your individual or joint Credit Union accounts." *Id.* Notwithstanding this language, the *Laues* court concluded that the credit union had a mere right of setoff rather than a security interest and granted

the turnover request because the exemption claim trumped any setoff right. *Id.* at 161-62. In reaching this conclusion, the court observed that "[a] transfer of a deposit account is specifically excluded from Article 9 of the Uniform Commercial Code" and that there was otherwise no state law authority which supported the validity of a lien on the account. *Id.* at 161.

The court also noted that:

The relationship between the Credit Union and the debtors regarding the checking account is that of debtor/creditor, and it is difficult to comprehend how a loan from the Credit Union can be secured by a debt which the Credit Union owes. Pledges are recognized under the North Carolina common law, but a pledge "is a deposit of personal effects, not to be taken back, but on payment of a certain sum, by express stipulation, to be a lien upon it." *Doak v. Bank of State*, 28 N.C. 309, 319, 6 Ired. 309 (1846). The Credit Union does not hold the deposit as bailee of the debtor, but as the debtor's account debtor.

Id. at 161-62. See also *Smith v. Barnett Bank of Pinellas County (In re Cravey & Ass'ns, Inc.)*, 109 B.R. 472, 473 (Bankr. M.D. Fla. 1989)(In rejecting bank's assertion that it had a security interest in debtor's bank account, the court observed that "the funds held in a checking account are regarded as property of the bank on which the depositor merely has a claim" and concluded under Florida law that "it is not possible for the bank to be the pledgee of its own property.").

In its memorandum of law, KTVA distinguishes the *Laues*

ruling by noting that contrary to North Carolina law, "Tennessee law provides for perfection of security interests in deposit accounts." As authority for this proposition, KTVA cites TENN. CODE ANN. § 47-4-609(a) which provides that "[a] credit union shall have a lien on the shares of any member and on the dividends payable thereon for and to the extent of any loan made the member and of any dues and fines payable by the member." KTVA asserts that a credit union is not required to take any action to perfect this lien and that at the time of the *Laues* decision, there was no similar credit union lien statute in North Carolina. KTVA also maintains that since *Laues*, the Revised Uniform Commercial Code has been adopted by both North Carolina and Tennessee, which revision includes the creation of a security interest in a bank account, which may be perfected by control.

With respect to the latter contention, the court notes that while it is correct that the Uniform Commercial Code has been revised to extend coverage of Article 9 to security interests taken in deposit accounts as original collateral, the extension is not unlimited. Expressly excluded from Article 9 is "an assignment of a deposit account in a consumer transaction." See TENN. CODE ANN. § 47-9-109(d)(13); N.C. GEN. STAT. ANN. § 25-9-109(d)(13). A consumer transaction is one in which both the

deposit account is held and the debt was incurred "primarily for personal, family or household purposes." See TENN. CODE ANN. § 47-9-102(a)(26). Although there is nothing in the court file to indicate that the debtor herein held her accounts at KTVA other than for personal purposes and that her debts to KTVA were incurred for other than personal reasons, these facts have not been stipulated by the parties. Accordingly, in the event KTVA's motion for relief and exemption objection hinge on whether Article 9 of the Revised Uniform Commercial Code applies to the transactions between the parties, it will be necessary for parties to stipulate additional facts or for the court to conduct an evidentiary hearing in this regard.

As previously noted, however, KTVA also relies on TENN. CODE ANN. § 45-4-609(a) which provides that a credit union shall have a lien on the deposits of any member to the extent of any loan made by the credit union to the member. Although there are no reported decisions which specifically address § 45-4-609(a), there are a few bankruptcy court decisions which have considered similar statutes in other jurisdictions. In *Frederick v. America's First Credit Union (Matter of Frederick)*, the debtors contested the bank's setoff of their credit union account against the debtors' MasterCard account based upon the contention, *inter alia*, that the deposited funds were exempt.

Matter of Frederick, 58 B.R. 56 (Bankr. N.D. Ala. 1986). The bankruptcy court concluded that because ALA. CODE ANN. § 5-17-14 gives a credit union a lien on all shares and deposits of a member for all sums due to the credit union and this lien was not avoidable in the bankruptcy proceeding, the deposited funds were impaired to the extent that they were subject to the credit union's lien, even if technically exempt. *Id.* at 58.

Similarly, in *In re Hinderks*, the bankruptcy court considered IOWA CODE ANN. § 533.12 which provides that "[t]he credit union shall have a lien on the shares and deposits of a member for any sum due to the credit union from the member or for any loan endorsed by the member." *In re Hinderks*, 1989 WL 434164, *8 (Bankr. N.D. Iowa May 26, 1989). As in the present case, the credit union in *Hinderks* had requested relief from the stay in order to setoff, pursuant to § 533.12, the debtor's credit union account against the obligation owed the credit union by the debtor, to which the debtor objected on the basis that the funds were exempt. *Id.* In resolving the issue, the court first recognized that "Iowa case law and most bankruptcy courts hold that a creditor may not reach exempt property through setoff." *Id.* at *6. The court also referenced Judge Kelley's *Riggsby* decision and *In re Laues*, specifically the latter's observation that there was no state statute addressing

the pledge of a bank account by a depositor. *Id.* at *8 (citing *In re Riggsby*, 35 B.R. at 441; *In re Laues*, 90 B.R. at 161). Because of the statutory lien granted by IOWA CODE ANN. § 533.12, the *Hinderks* court distinguished *In re Laues* and adopted *Matter of Frederick*, concluding that "the Iowa statutory credit union lien overrides the Debtors' claim of exemption in the Debtors' accounts in the Credit Union." *Id.* at *8. See also *In re Dragoo*, 1998 WL 34064941, *2 (Bankr. C.D. Ill. Aug. 27, 1998)(notwithstanding debtor's exemption claim, the court granted credit union relief from stay in order to enforce its statutory lien against debtor's share draft account).

This court concludes that the *In re Hinderks* and *Matter of Frederick* decisions were correctly decided. As noted, the debtor does not dispute that the Loanliner Agreement and MasterCard credit card application signed by her granted KTVA a security interest in her accounts. Furthermore, the language in both documents appear sufficient to convey a security interest. See *In re Nottingham*, 1969 WL 110986, U.C.C. Rep. Serv. 1197, 1199 (Bankr. E.D. Tenn. Sept. 12, 1969) (quoted in *In re Frazier*, 16 B.R. 674, 678 (Bankr. M.D. 1981)("There are no magic words that create a security interest. There must be language, however, in the instrument which when read and construed leads

to the logical conclusion that it was the intention of the parties that a security interest be created.")).

This court respectfully disagrees with the conclusion in *In re Riggsby* and *In re Laues*, that this grant of a security interest is a mere setoff right. These courts and the decisions cited by them reached this conclusion in part by questioning how a loan from a bank could be secured by a debt which it owes. See, e.g., *In re Laues*, 90 B.R. at 161. It is clear, however, that security interests can be created in deposit accounts. As stated by the court in *Broadnax v. Prudential-Bache Securities, Inc. (In re Zimmerman)*:

"[M]oney deposited in a general account at a bank does not remain the property of the depositor. Upon deposit of funds at a bank, the money deposited becomes the property of the depository bank; the property of the depositor is the indebtedness of the bank to it, a mere chose in action." [Citations omitted.] As such, a deposit account is an intangible property interest which may be pledged.

In re Zimmerman, 69 B.R. 436, 438 (Bankr. E.D. Wis. 1987). See also *First Tennessee Bank v. Resolution Trust Corp. (In re Creekstone Apartments Assocs., L.P.)*, 165 B.R. 851, 854 (Bankr. M.D. Tenn. 1994) ("Under the common law, a perfected security interest in a deposit account is created by a pledge."); *In re Riggsby*, 34 B.R. at 441 ("[A] bank can have a security interest in a deposit pledged for security and in the bank's control.").

There appears to be no prohibition on the same entity being both the secured creditor and the depository institution. See, e.g, *Jefferson Bank and Trust v. United States*, 684 F. Supp. 1542 (D. Colo. 1988)(bank's security interest in customer's accounts took priority over levy by IRS); *CJL Co. v. Bank of Wallowa County (In re CJL Co.)*, 71 B.R. 261, 266 (Bankr. D. Or. 1987)(bank obtained valid pledge of debtor's right to withdraw funds deposited as collateral for letter of credit); *Duncan Box & Lumber Co.*, 270 S.E.2d at 145-46 (depositor pledged reserve account as security for loans made by the bank to the depositor). By extending the coverage of Article 9 to the creation of security interests in certain deposit accounts and specifically permitting perfection by control, the state of Tennessee expressly recognized the ability of a depositor to convey a security interest in its deposits to the depository institution where the account is maintained. See TENN. CODE ANN. § 47-9-104(a) ("A secured party has control of a deposit account if ... the secured party is the bank with which the deposit account is maintained"). The fact that the transactions between the parties may have been consumer ones does not alter this result. As the official comment to TENN. CODE ANN. § 47-9-109 explains, "By excluding deposit accounts from the Article's scope as original collateral in consumer transactions,

subsection (d)(13) leaves those transactions to law other than this Article." Official Comment 16.¹ Accordingly, this court concludes that debtor's loans from KTVA were secured by security interests in her deposit accounts at KTVA.²

In light of the conclusion that KTVA has security interests in the debtor's credit union accounts, it is not necessary for the court to evaluate the validity of the debtor's exemption claim. Even if the debtor's exemption claim is legitimate, "[a] valid lien or security interest on exempt property securing a prepetition debt remains enforceable unless the lien is void or

¹If the transactions between the parties were non-consumer ones, then they would be governed by Article 9 and KTVA would appear to have a security interest perfected by control as it asserts. If the transactions between the parties were consumer ones, it is not clear that the interest is perfected since "[u]nder the common law, a perfected security interest in a deposit account is created by a pledge" which requires that "the pledgee must have exclusive control over the funds in the account." *In re Creekstone Apartments Assocs., L.P.*), 165 B.R. at 854. "In a bank account where the depositor has access to the account through withdrawal rights [such as a checking account], it would be difficult, if not impossible, for the bank to demonstrate that the account constitutes a pledge in the absence of a showing that it has exclusive control over the account." *Duncan Box & Lumber Co.*, 270 S.E.2d at 146 n.11. Because the dispute herein is between the debtor and her secured creditor, as opposed to competing creditors or the bankruptcy trustee and KTVA, the court need not ascertain whether KTVA's security interest is a perfected one.

²The court similarly concludes, consistent with the *In re Hinderks* and *Matter of Frederick* decisions construing similar provisions, that KTVA also has a statutory lien pursuant to TENN. CODE ANN. § 45-4-609(a).

is avoided pursuant to one of a number of avoidance provisions in the Bankruptcy Code." *In re Bensen*, 262 B.R. 371, 378-79 (Bankr. N.D. Tex. 2001)(citing 11 U.S.C. § 522(c)³). As recently stated by one bankruptcy court:

Exemptions do not impair or destroy lien rights held by creditors. If property, such as a bank account or impounded wages, is burdened by lien(s) at the time of the filing of the bankruptcy, the debtor's interest in such property becomes property of the bankruptcy estate subject to such liens. Unless the liens are avoided by a specific bankruptcy code

³Section 522(c) of the Bankruptcy Code provides:
Unless the case is dismissed, property exempted under this section is not liable during or after the case for any debt of the debtor that arose, or that is determined under 502 of this title as if such debt had arisen, before the commencement of the case, except—
(1) a debt of a kind specified in section 523(a)(1) or section 523(a)(5) of this title;
(2) a debt secured by a lien that is—
 (A)(i) not avoided under subsection (f) or (g) of this section or under section 544, 545, 547, 548, 549, or 724(a) of this title; and
 (ii) not void under section 506(d) of this title;
 (B) a tax lien, notice of which is properly filed; or
(3) a debt of a kind specified in section 523(a)(4) or 523(a)(6) of this title owed by an institution-affiliated party of an insured depository institution to a Federal depository institution[']s regulatory agency acting in its capacity as conservator, receiver, or liquidating agent for such institution; or
(4) a debt in connection with fraud in the obtaining or providing of any scholarship, grant, loan, tuition, discount, award, or other financial assistance for purposes of financing an education at an institution of higher education (as that term is defined in section 101 of the Higher Education Act of 1965)(20 U.S.C. 1001)).

provision or an order of the bankruptcy court, the lien "rides through" the bankruptcy case and remains impressed upon the property after the conclusion of the case. [Citations omitted.]

When the debtor asserts an allowed exemption for all of the estate's interest in liened property, the bankruptcy estate's interest in the property passes back to the debtor but still subject to the lien(s) (unless the lien(s) have been avoid as aforementioned). The selection by debtor of the property as exempt property does not by itself destroy liens.

Drazenovich v. Ford Motor Credit (In re Drazenovich), 292 B.R. 101, 108 (Bankr. D. Md. 2003).

The debtor herein has taken no action to avoid the security interests and liens of KTVA and the court knows of no Bankruptcy Code provision which would permit such avoidance. Thus, the debtor's deposits at KTVA remain subject to KTVA's liens notwithstanding the debtor's exemption claim. The debtor's confirmed plan makes no provision for payment of KTVA's secured claim nor for adequate protection of its interests. Accordingly, relief from the stay is appropriate.

III.

The court will enter an order in accordance with this memorandum opinion granting KTVA's motion for relief from the automatic stay. In light of this ruling, KTVA's objection to the debtor's exemption claim will be overruled as moot.

FILED: May 28, 2003

BY THE COURT

MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE