

1 not pay off his Visa credit card. Therefore, KMFCU repossessed the Buick to collect
2 the Visa debt.

3 Kim refuses to classify KMFCU as a secured creditor or provide
4 adequate protection of its interest. He argues he was unaware of the cross-
5 collateralization clause, and never intended to grant the Buick as collateral to secure
6 repayment of the Visa debt. No one from KMFCU pointed out the cross-
7 collateralization clause; nor did they explain the Buick would secure his Visa debt.
8 Accordingly, the cross-collateralization clause is unenforceable due to his lack of
9 intent.

10 Additionally, Kim argues KMFCU acted inequitably. Kim's prior
11 chapter 7 bankruptcy discharged his personal liability. KMFCU allowed Kim to
12 retain the Buick and pay the car loan to create equity in the Buick. It never disclosed
13 it would repossess the Buick after the loan was fully paid.

14 Because KMFCU's security interest is disputed, the Court ordered the
15 Buick returned pending an evidentiary hearing on whether it was entitled to adequate
16 protection. The Court has jurisdiction over this proceeding pursuant to 28 U.S.C.
17 § 1334 and General Order 312-D of the United States District Court. This is a core
18 proceeding pursuant to 28 U.S.C. §§ 157(b)(2)(B) and (K). After considering all the
19 evidence and the arguments of counsel, the Court denies KMFCU relief from the
20 automatic stay and denies its request for adequate protection as a secured creditor.

21 II.

22 FACTUAL BACKGROUND

23 Sometime in late 1995, Kim, an inspector at Solar Turbines, Inc.,
24 purchased a 1996 Buick Regal for \$20,000, financing the purchase through KMFCU.
25 On September 14, 1995, he executed a multi-page document titled "Disclosure
26 Statement, Loan Agreement and Security Agreement" ("Loan No. 1"), giving the car
27

1 as security for the purchase price. The Security Agreement portion of Loan No. 1
2 includes a cross-collateralization clause which provides:

3 To protect us in case you default on your loan, you give us
4 a security interest in the property [collateral] described on
5 the attached page. This security interest will cover both the
6 property listed and any additions you may make to it as
7 well as the proceeds from the sale of the property. **You
agree that this collateral secures other loans you have
with us, and collateral securing other loans also secures
this loan.** This cross-collateral agreement does not apply
to any property used as your dwelling.

8 [Exhibit 1] (Emphasis added.) The cross-collateralization clause is located on a
9 different page than the interest rate and payment amount.

10 On January 6, 1996, Kim applied for a Visa credit card through
11 KMFCU, executing a multi-page agreement which provided that the credit card
12 would be paid by automatic deduction from his credit union account. The Visa card
13 agreement does not reference Loan No. 1. After verifying his good credit, Kim was
14 issued a Visa card with a \$10,000 limit.

15 Kim decided to refinance Loan No. 1 to take advantage of a lower
16 interest rate and shorter payment term. On February 5, 1996, he executed another
17 Disclosure Statement, Loan Agreement and Security Agreement ("Loan No. 2") with
18 KMFCU which contained the exact terms as Loan No. 1 except for the lower interest
19 rate and shorter payment term.

20 Kim, an immigrant from Viet Nam who speaks and reads limited
21 English, testified that when he signed Loan No. 1, he did not read the entire
22 document but only those parts pointed out to him by the loan officer. According to
23 his testimony, the only parts the loan officer pointed out to him, other than the interest
24 rate and the payment amount, were the places to sign on the document. No one
25 explained to him or pointed out the cross-collateralization clause.

26 When Kim applied for the Visa loan, no one from KMFCU explained to
27

1 him that the Buick would be collateral for the Visa debt.

2 Finally, when Kim signed Loan No. 2, no one from KMFCU explained
3 to him that the Buick would be collateral for the Visa debt or any other debts he had
4 with the credit union. Once again, he read the first page of the agreement setting
5 forth the interest rate, payment amount and term and then signed where directed by
6 the KMFCU loan officer. Once again, no one explained to him or pointed out the
7 cross-collateralization clause.

8 In August 1996, Kim filed a chapter 7 bankruptcy. He received a
9 discharge on December 12, 1996. He was represented by an attorney who told him
10 that the Visa debt would be discharged in his bankruptcy but if he desired to keep the
11 car, he had to make the monthly payments until the car was paid off. And that is
12 exactly what Kim did: Every week \$112 was deducted from his account. And every
13 month KMFCU sent him statements showing credits for these payments. Nothing on
14 these statements indicated he would have to pay the Visa bill when his payments on
15 the car loan were completed. Further, KMFCU did not send him any Visa statements
16 showing a balance remained due.

17 Sometime in July 2000, Kim received a KMFCU statement showing that
18 as of June 30, 2000, his balance on Loan No. 2 was "0". When he attempted to
19 obtain the vehicle title, he was told by KMFCU's attorney that he still owed
20 \$10,242.68 on the unpaid Visa account scheduled in his chapter 7 bankruptcy.

21 Kim and his wife conferred and decided this must be a mistake. They
22 did not seek legal assistance, they ignored KMFCU's attorney's letter and they made
23 no attempt to repay the Visa debt. When their car was repossessed by KMFCU, Kim
24 filed this chapter 13 case. KMFCU moves for relief from stay, claiming it must be
25 classified as a secured creditor and its security interest in the vehicle has not been
26 adequately protected.

1
2 **III.**
3 **ISSUES**

- 4 1. Is the Visa debt covered by the Security Agreement?
5 2. How does the Court determine the intent of the parties?
6 3. Is the standard for determining intent of the parties applied only to
7 future advances, or is it applicable to antecedent debts?
8 4. Did KMFCU act inequitably?

9 **IV.**
10 **LEGAL ANALYSIS**

11 **1. Is the Visa Debt Covered by the Security Agreement?**

12 The parties do not dispute that a valid security agreement was created.
13 Rather, Kim contends the parties never intended the security agreement to cover the
14 Visa debt. KMFCU counters that the security agreement clearly states that it covers
15 all of Kim's loans and he should have known the security agreement covered the Visa
16 debt. KMFCU argues the parties' intent is irrelevant in a transaction governed by the
17 Commercial Code.

18 KMFCU is incorrect. In a transaction governed by the Commercial
19 Code, the scope of the security agreement is determined by the intent of the parties.
20 *New West Fruit Corp. v. Coastal Berry Corp.*, 1 Cal. App. 4th 92, 98-99 (1991). *New*
21 *West Fruit* involved a dragnet clause similar to the one in this case. In that case, a co-
22 op of strawberry growers entered into an agreement to obtain advances from a
23 broker/lender. In exchange, the growers agreed to grant the broker/lender a security
24 interest in their crops to secure *all of their obligations* under the agreement. *New*
25 *West Fruit*, 1 Cal. App. 4th at 95.

26 Thereafter, a dispute arose as to the validity and scope of the security
27

1 agreement. *Id.* at 96. The court recognized the agreement need not specify the exact
2 debts to create a valid security agreement. *Id.* 98. As to the scope of the secured
3 obligations, the court held that the pivotal question is the intent of the parties:

4 The pivotal question, therefore, is whether the challenged
5 obligation [advances] is covered by the security agreement.
6 This question can be answered only by ascertaining the
7 intent of the parties to the transaction

8 As noted above, the critical factor in defining the
9 parameters of a security agreement is the intent of the
10 parties

11 *Id.* at 98-99. In ascertaining their intent, the court looked to the parties’ reasonable
12 expectations, utilizing the general principles governing commercial agreements as
13 well as the specific rules pertaining to secured transactions. *Id.* at 99.

14 According to *New West Fruit*, the critical inquiry is the intent of the
15 parties. The Court must ascertain the parties’ reasonable expectations to secure the
16 Visa debt.²

17 **2. How Does the Court Determine The Intent of the Parties?**

18 Next, the Court must decide the appropriate method of determining the
19 parties’ intent. Kim asks the Court to apply the “relationship of loans” and “reliance
20 on the security” tests adopted by the California Court of Appeals in *Wong v.*
21 *Beneficial Sav. & Loan Ass’n*, 56 Cal. App. 3d at 295 and *Union Bank v. Wendland*,
22 54 Cal. App. 3d 393, 404 (1976). KMFCU disagrees, claiming these tests are
23 inapplicable because they were adopted in cases that involved real property. It argues
24 that real property cases have unique anti-deficiency concerns not present in personal

25 ² Other non-Commercial Code cases are in accord. *See Wong v. Beneficial Sav. &*
26 *Loan Ass’n*, 56 Cal. App. 3d 286, 293 (1976)(recognizing that “California courts have rather
27 consistently tended to prefer a construction that is more faithful to the parties’ actual expectations
28 than to the literal wording of the [dragnet] clause”).

1 property secured transactions and it is these concerns which influenced the decisions
2 to use these tests.

3 . This Court is not persuaded by KMFCU’s analysis. A review of these
4 cases reveals only *Wendland* even mentioned the anti-deficiency legislation. Further,
5 the *Wong* court’s exhaustive discussion of dragnet clauses indicates that the court was
6 more concerned with the inherent possibility of overreaching and inequity in enforcing
7 these clauses than it was with any aspect of California real property law. *Id* at 292-
8 296. Accordingly, the Court disagrees that “anti-deficiency” concerns limit these tests
9 to real property cases.

10 Although there is no California case directly on point, *New West Fruit*
11 instructs that these tests also apply to the cases involving the Commercial Code.
12 Specifically, the court indicated it must utilize both specific provisions in the
13 Commercial Code and the “general principles governing commercial agreements” to
14 determine the intent of the parties, recognizing implicitly that other tests are
15 appropriate. *Id* at 99.

16 At least two other courts have held that these tests apply to cases
17 involving the California Commercial Code. The bankruptcy court in *In re Gibson*,
18 234 B.R. 776, 781 n. 2 (Bankr. C.D. Cal. 1999), indicated it would apply *Wendland*
19 and *Wong* to a dragnet clause to ascertain the parties’ intent. As in this case, *Gibson*
20 considered whether a dragnet clause executed in connection with a car loan covered
21 the debtor’s credit card debt. *Gibson*, 234 B.R. at 778. The court applied Illinois law
22 because of the choice of law provision in the security agreement. *Id.* at 779-80. It
23 invalidated the dragnet clause under Illinois law, and indicated it would have reached
24 the same result if California law applied. *Id.* at 781 n.2. Although not fully explained,
25 the court appears to conclude the parties could not have intended the dragnet clause
26 to cover the credit card debt where the debtor was unaware of its inclusion in the

1 security agreement.

2

3

4

5

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

26

27

28

1 Similarly, the Ninth Circuit Bankruptcy Appellate Panel (“BAP”) in *In*
2 *re Auza*, 181 B.R. 63, 68 (9th Cir. BAP 1995) applied *Wendland* and *Wong* to a dragnet
3 clause covering loans secured by both real and personal property. The BAP indicated
4 Arizona courts have adopted the tests enumerated in *Wendland* and *Wong* as the
5 controlling tests in Arizona. *Auza*, 181 B.R. at 68. The *Auza* court found the
6 language in the dragnet clause clear and unambiguous. *Id.* at 69. Notwithstanding, it
7 invalidated the dragnet clause because the “reliance on the security” test was not met.
8 *Id.* at 70.³

9 The Court is persuaded by the above authorities. Therefore, it holds the
10 “relationship of loans” and “reliance on the security” tests also apply to cases arising
11 under the Commercial Code.⁴

12 KMFCU did not argue either test was met, even though it bears the
13 burden of establishing both parties’ intent. *See Wong*, 56 Cal. App. 3d at 294
14 (indicating the burden should be on the proponent to show both parties’ intent to
15 include the challenged debt). Notwithstanding, the Court will explain why neither test
16 has been met.

17 First, in applying the “relationship of loans” test, the Court examined the
18 relationship of the car loan and the Visa debt to each other. *See Wendland*, 54 Cal.
19 App. 3d at 404 (“relationship of loans” examines the relationship of the two loans to
20 each other to infer the parties’ intent to secure both debts). It finds the car loan and
21 Visa debt unrelated except for their classification as consumer debts. The Court is
22 aware that some courts have found debts “of the same class” sufficiently related to

23
24 ³ Again, the BAP indicated some of the collateral consisted of personal property. *Id.*

25 ⁴ The Court is aware of new U.C.C. § 9-204, effective July 1, 2001, and Official
26 Comment No. 5, which rejects the continued use of these tests to ascertain the parties’ intent. It
27 is premature to address the effect of this directive on existing case law.

1 meet the relationship of loans test. *See e.g. In re James*, 221 B.R. 760, 764 (Bankr.
2 W.D. Wis. 1998)(finding car loan and credit card debt sufficiently related because they
3 are “of the same class”). But *Wendland* instructs otherwise. Specifically, *Wendland*
4 holds that the two loans must *relate to each other* to satisfy the “relationship of loans”
5 test. *Wendland*, 54 Cal. App. 3d at 404 (loans related if, for example, they relate to
6 improvements on the same real property). There is no evidence the car loan and Visa
7 debt *relate to each other*. Accordingly, the “relationship of loans” test is not met.

8 Similarly, the “reliance on the security” test is not met. This test looks
9 to whether the creditor made the second loan in reliance on the original security. *Id.*
10 at 404-5. There is no evidence KMFCU approved the credit card in reliance on the
11 Buick. To the contrary, KMFCU testified it verified Kim’s good credit and issued the
12 card. The Visa application does not reference the Buick. In summary, neither test has
13 been met.

14 **3. Do the Same Standards Apply to Antecedent Debts?**

15 Additionally, KMFCU argues the intent of the parties is not relevant
16 where a security agreement secures antecedent debts. Because the Visa credit card
17 was approved *before* Loan No. 2, it argues the Visa debt is an antecedent debt. This
18 argument places form over substance and ignores the parties’ relationship from its
19 inception. Further, this argument assumes all the Visa charges were incurred *before*
20 Loan No. 2 when no evidence of this fact was presented. Accepting KMFCU’s
21 characterization as correct, it is irrelevant; the same standard applies to antecedent
22 debts.

23 Again, *New West Fruit* is instructive. In that case, the record showed the
24 advances were made before and after the agreement was executed. *New West Fruit*,
25 1 Cal. App. 4th at 100. Notwithstanding, the court applied the same standard for all of
26 the advances. *Id.* The critical inquiry was the intent of the parties to secure the
27

1 of this case further support the decision to deny the motion.

2 **V.**

3 **CONCLUSION**

4 The Court denies KMFCU’s motion for relief from stay or, in the
5 alternative, for adequate protection because it failed to establish the Security
6 Agreement in Loan No. 2 includes the discharged Visa debt. The literal language
7 could have included the Visa debt, but the parties’ intent was otherwise. Further,
8 KMFCU has acted inequitably. Overall principles of fairness and equity support the
9 Court’s decision to deny the motion.

10 This Memorandum Decision is in lieu of findings of fact and conclusions
11 of law. Counsel for Kim is directed to prepare and lodge an order in accordance with
12 this Memorandum Decision within ten days of the date of its entry.

13
14 Dated: _____

15 LOUISE DeCARL ADLER, Chief Judge

1 CAD 168
[Revised July 1985]

2
3 **UNITED STATES BANKRUPTCY COURT**
4 **SOUTHERN DISTRICT OF CALIFORNIA**

5 In re Bankruptcy Case No(s). 00-07243-A13; RS No. TJS-001
6 Case Name: In Re: David Son Kim

7 **CERTIFICATE OF MAILING**

8 The undersigned, a regularly appointed and qualified clerk in the Office of the United States
9 Bankruptcy Court for the Southern District of California, at San Diego, hereby certifies that a true
10 copy of the attached document, to-wit:

11 **MEMORANDUM DECISION**

12
13 was enclosed in a stamped and sealed envelope and mailed to the following parties at their respective
14 addresses listed below:

15 Timothy J. Silverman, Esq.
SOLOMON GRINDLE SILVERMAN
& SPINELLA
16 12555 High Bluff Drive, Suite 260
San Diego CA 92130

Thomas H. Billingslea
Chapter 13 Trustee
530 "B" Street, Suite 1500
San Diego CA 92101

17 Jonathon R. DeSimone, Esq.
18 1901 First Avenue, Second Floor
San Diego CA 92101

19
20 The envelope(s) containing the above document was deposited in a regular United States mail box
21 in the City of San Diego in said district on December 11, 2000

22
23 _____
24 CAD 168

_____, Deputy Clerk
Roma London