UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re:

CASE NO. 99-23772

WILLIAM M. LUDDEN and
THERESA LUDDEN,

Debtors. **DECISION & ORDER**

BACKGROUND

On December 6, 1999, William M. and Theresa Ludden (the "Debtors") filed a petition initiating a Chapter 7 case.

On December 23, 1999, Steuben Educators Federal Credit Union ("Steuben") filed a motion for relief from the automatic stay provided for by Section 362 (the "Setoff Motion") which asserted that: (1) the Debtors were indebted to Steuben in the amount of $6,232.32 pursuant to a July 31, 1995 Loanliner Note and Disclosure Statement (the "Steuben Note"), executed by William Ludden, as borrower, and Theresa Ludden, as co-borrower; (2) by the terms of the Steuben Note, the Note was secured by all of the Debtors' shares in the credit union and all deposits in all individual and joint accounts maintained with Steuben;[1] (3) by the terms of the Steuben Note, filing for bankruptcy was a default which entitled Steuben to the immediate payment of any and all amounts due on the Note and allowed Steuben to apply all shares and deposits against the balance due on the Note; (4)

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[1] The relevant portion of the Steuben Note reads as follows:

> In addition, you agree this loan is also secured by all shares and deposits in all your individual and joint accounts with the credit union now and in the future.

at the time of the filing of her petition, Theresa Ludden maintained a joint account at Steuben with her daughter, Melissa Ludden, which had a balance of approximately $2,000.00 (the "Melissa Ludden Account"); (5) at the time of the filing of her petition, Theresa Ludden maintained an account with her son, Todd Ludden, which had a balance of approximately $4,230.00 (the "Todd Ludden Account"); (6) Steuben had placed an administrative hold on these Accounts so that it could make the Setoff Motion; and (7) the Court should terminate the automatic stay so that Steuben could exercise its alleged right to apply the amounts on deposit in the Melissa and Todd Ludden Accounts to the amounts due on the Steuben Note.

On January 21, 2000, the Debtors interposed a "Response" to the Setoff Motion which asserted that: (1) Todd Ludden was born on January 27, 1981, so that he was eighteen years old when the Debtors filed their petition; (2) Melissa Ludden was born on December 30, 1979, so that she was twenty years old when the Debtors filed their petition; (3) the Todd Ludden and Melissa Ludden Accounts were each held in the joint name of Theresa Ludden as a convenience only, since all of the funds on deposit in each of the Accounts belonged exclusively to Todd Ludden and Melissa Ludden respectively; (4) until March 1998, most of the monies now on deposit in the Melissa Ludden Account had been in an account with Prudential which was maintained in the name of William Ludden as Custodian Under the New York Uniform Gifts to Minors Act; and (5) until December 1998, most of the monies now on deposit in the Todd Ludden Account had been in an account with Prudential which was maintained in the name of William Ludden as Custodian Under the New York Uniform Gifts to Minors Act.

On January 21, 2000, the attorney for the Debtors filed an affidavit (the "Attorney's Affidavit") which alleged that: (1) Steuben could not offset the amounts on deposit in the Melissa

and Todd Ludden Accounts pursuant to Section 553(a)[2] because Steuben could not demonstrate the existence of a number of the requirements for a valid common law setoff, including the requirement that there be mutual debts; (2) since Melissa and Todd Ludden were infants when they signed the Agreements governing their Accounts, they could not have contemplated or foresaw that the amounts on deposit in their Accounts could be offset by Steuben in the event that Theresa Ludden filed bankruptcy; and (3) the Melissa and Todd Ludden Accounts were each "special use accounts," so that Steuben could not offset them against Theresa Ludden's indebtedness on the Steuben Note.

On January 27, 2000, Steuben filed the Affidavit of one of its Officers, Darlene M. Foster, (the "Foster Affidavit") which alleged that: (1) a recently computed review of the records and histories of the Melissa and Todd Ludden Accounts indicated that while Theresa Ludden made

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[2] Section 553(a) provides that:

> (a) Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case, except to the extent that—
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> (1) the claim of such creditor against the debtor is disallowed;
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> (2) such claim was transferred, by an entity other than the debtor, to such creditor—
>
> (A) after the commencement of the case; or
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> (B) (i) after 90 days before the date of the filing of the petition; and
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> (ii) while the debtor was insolvent; or
>
> (3) the debt owed to the debtor by such creditor was incurred by such creditor—
>
> (A) after 90 days before the date of the filing of the petition;
>
> (B) while the debtor was insolvent; and
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> (C) for the purpose of obtaining a right of setoff against the debtor.

11 U.S.C. § 553(a) (1998).

nearly all of the deposits and withdrawals in the accounts, most of the deposits were of checks made payable to Melissa and Todd Ludden respectively; (2) on July 16, 1998 Melissa Ludden and Theresa Ludden executed a Joint Share Account Agreement in connection with the Melissa Ludden Account and on June 25, 1998 Todd Ludden and Theresa Ludden executed an identical Joint Share Account Agreement (the "Joint Share Account Agreements")[3] by which they agreed that: (a) the amounts on deposit in the Melissa and Todd Ludden Accounts were owned jointly with Theresa Ludden with right of survivorship; (b) any joint owner could pledge all or any part of the amounts on deposit as collateral security for a loan from the credit union;[4] and (3) Steuben had offered to release the amounts in the Melissa and Todd Ludden Accounts if the Debtors reaffirmed the amounts due on the Steuben Note.

DISCUSSION

I. Steuben's Motion for Relief from the Stay

The Setoff Motion brought by Steuben is a motion to terminate the automatic stay provided for by Section 362 to permit Steuben to exercise any and all rights it may have with respect to the

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[3] Todd was 17 years old when he executed the Joint Share Agreement. However, he was 18 years old by July, 1999 as well as at the time the debtors filed their petition. Melissa was 18 years old when she executed the Agreement.

[4] The relevant portions of the Joint Share Account Agreements read in part as follows:

> The joint owners agree with each other and with said credit union that all sums . . . are and shall be owned by them jointly with right of survivorship and be subject to the withdrawal or receipt of any of them, and payment to any of them . . . shall be valid and discharge said credit union from any liability for such payment.
>
> Any or all of said joint owners may pledge all or any part of the shares in this account as collateral security, to a loan or loans from the credit union.

amounts on deposit in the Melissa and Todd Ludden Accounts. Section 362(a)(2)-(7)[5] sets forth a number of potential actions which Steuben might take in the exercise of its alleged rights that were stayed with the filing of the Debtors' petition, so that in the early stages of the case it was proper for Steuben to make the Setoff Motion.

Section 362(c) provides in part that:

> (1) the stay of an act against property of the estate under subsection (a) of this section continues until such property is no longer property of the estate; and
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> (2) the stay of any other act under subsection (a) of this section continues until the earliest of –
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> (A) the time the case is closed;
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> (B) the time the case is dismissed; or

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[5] Section 362(a)(2-7) provides as follows:

> (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;
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> (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;
>
> (4) any act to create, perfect, or enforce any lien against property of the estate;
>
> (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;
>
> (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title; and
>
> (7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor.

11 U.S.C. § 362 (a)(2-7) (2000).

> (C) if the case is a case under chapter 7 of this title concerning an individual or a case under chapter 9, 11, 12, or 13 of this title, the time a discharge is granted or denied.

At this time there is no reason for the Court to deny Steuben's Setoff Motion because the automatic stay provided for by Section 362 has terminated as to any rights which Steuben may have to apply the amounts on deposit in the Melissa and Todd Ludden Accounts against the amounts due on the Steuben Note for the following reasons: (1) the amounts on deposit in the Melissa and Todd Ludden Accounts are not property of the Debtors' bankruptcy estate because: (a) the Debtors' trustee (the "Trustee") did not interpose an answer or otherwise appear in connection with the Setoff Motion, which indicated that either he did not believe that such amounts on deposit were property of the estate, or, if they were property of the estate, Steuben had demonstrated that it had a perfected security interest in those deposits; (b) on March 31, 2000 the Trustee filed a report that there was no property available for distribution from the estate (the "No Asset Report"), which confirmed that the amounts on deposit in the Melissa and Todd Ludden Accounts were not property of the estate; and (c) the Debtors' principal response to the Setoff Motion was that the beneficial ownership of all of the amounts on deposit was in Melissa and Todd Ludden, and Theresa Ludden was on the Accounts for convenience only; and (2) to the extent that any other act that Steuben might take in the exercise of its alleged rights might be prohibited by any other provision of Section 362(a)(2)-(7), the automatic stay terminated as to those acts because on March 30, 2000 an Order of Discharge was entered in the Debtors' case.

Therefore, since the automatic stay provided for by Section 362 has been terminated as to the actions which Steuben asserts that it can take, as to this Court, this matter is moot. However, the

Court will enter an Order terminating the stay because the Setoff Motion was before it for decision prior to the filing of the No Asset Report and the entry of the Order of Discharge.

II. Steuben's Contractual Rights

Because the automatic stay has terminated as to the actions which Steuben asserts that it can take, the application of the amounts on deposit in the Melissa and Todd Ludden Accounts, which is not property of the estate, to the amounts due on the Steuben Note, this Court does not need to determine whether Steuben has the contractual right to make such an application.

However, if this Court did have to make that decision, based upon: (1) the clear language of the Steuben Note, executed by the Debtors, and the Joint Share Account Agreements, executed by Melissa, Todd and Theresa Ludden; and (2) the failure on Todd Ludden when he reached 18 years old to in anyway disaffirm the provisions of the Joint Share Account Agreement which he executed when he was 17, the Court would conclude that Steuben has a valid security interest in the Accounts and a right to apply the amounts on deposit to the amounts due on the Steuben Note.

Even though Melissa and Todd Ludden may be the beneficial owners of the Accounts which they maintained at Steuben with their mother: (1) Steuben was granted a security interest, in the form of a pledge, in the amounts on deposit in the Melissa and Todd Ludden Accounts by Theresa Ludden; (2) Theresa Ludden was authorized to make such a pledge by Melissa and Todd Ludden by the terms of the Joint Share Account Agreements which they executed; and (3) Steuben was granted the right to apply those amounts on deposit against the indebtedness due to it as evidenced by the Steuben Note once Theresa Ludden defaulted on the Note.

When Theresa Ludden, as co-borrower, executed the Steuben Note, she granted Steuben a security interest in any and all joint accounts in which she had an interest, either then existing or

coming into existence in the future. Because the language covered future accounts, it was sufficiently broad to cover the Melissa and Todd Ludden Accounts.

By executing their respective Joint Share Account Agreements, Melissa and Todd Ludden, even though: (1) they may have been the sole beneficial owners of all the monies on deposit in those accounts; and (2) those accounts were maintained with their mother, Theresa Ludden for convenience only, agreed that, as to Steuben, Theresa Ludden was a joint owner of the account and that as a joint owner she could pledge all of the account as collateral security to "any" loan from Steuben. The loan evidenced by the Steuben Note was clearly in existence at the time the Joint Share Account Agreements were executed, and, as discussed above, contained clear and sufficient language to collateralize the Note with any future account that Theresa Ludden had an interest in or was otherwise authorized to pledge as collateral for the Note.

Section 3-101 of the New York General Obligations Law sets forth the contractual age of majority at 18. Although Todd Ludden was not yet 18 when he executed the Joint Share Account Agreement, by January 27, 1999 Todd Ludden had turned 18. There is no dispute that between January 27, 1999 and the date of the petition, December 6, 1999, Todd Ludden did nothing to disaffirm the terms of the Joint Share Account Agreement that he had executed. Rather, the evidence indicates that he continued to allow his mother, Theresa Ludden, to make deposits and withdrawals to the account, which constituted a recognition, confirmation and ratification of the Agreement. See *Henry v. Root*, 33 N.Y. 526 (NY 1965).

III. Steuben's Common Law Right of Setoff

It is also unnecessary for the Court to analyze in detail whether Steuben could prevail on a common law or "bankers" right of setoff. With regard to that issue, however, it is clear that the

Melissa and Todd Ludden Accounts are not "special use accounts" as those were discussed in detail in *In re Bennett Funding Group*, 212 B.R. 206 (2d Cir. BAP 1997), aff'd 146 F.2d 136 (2d Cir. 1998).

IV. Overview

Although it may appear to some to be inequitable for Todd and Melissa Ludden's funds to be applied to their mother's indebtedness to Steuben, that result is not because of anything contained in the Bankruptcy Code or Rules, but is based upon New York State Law and the terms of the documents which the parties executed. The same result would occur if there had been no bankruptcy, Theresa Ludden had otherwise defaulted on her obligation to pay the Steuben Note and Steuben elected to enforce its rights under the Note and the Joint Share Account Agreements.

If these monies are so applied, it will be as the result of the rights which Melissa, Todd and Theresa Ludden granted to Steuben by executing the Steuben Note and the Joint Share Account Agreements. If they had read the Joint Share Account Agreement carefully, they could have anticipated this result, because the language of the Agreement is clear. If they failed to carefully read the Agreements which they executed, it is difficult to understand why they believe that any Court should protect them from the resulting consequences.

CONCLUSION

The stay provided by Section 362 is terminated to allow Steuben to exercise any and all rights that it may have with regard to the Melissa and Todd Ludden Accounts.

IT IS SO ORDERED.

_____/s/_____
HON. JOHN C. NINFO, II
CHIEF U.S. BANKRUPTCY JUDGE

Dated: July 10, 2000