SECURITY INTERESTS IN DEPOSIT ACCOUNTS

I. **Introduction**. Under old Article 9 as enacted in most states, former §9-104 (which described the scope of Article 9) excluded security interests (or **SI**) in deposit accounts from the coverage of the UCC. (In a few states, such as California and Illinois, amendments had been adopted to old Article 9 to include a security interest in deposit accounts within the scope of Article 9. In those states, a security interest in deposit accounts could be perfected by filing a financing statement (or **FS**).) Current §9-109 describes the scope of revised Article 9. It does not contain an exclusion of deposit accounts from the scope of Article 9. Under revised Article 9, a security interest may be perfected in a deposit account. The revised UCC provides express procedures to perfect a security interest in deposit accounts similar to, but not identical with, procedures specified to perfect a security interest in a securities account. These procedures do not, however, allow perfection in a deposit account by filing a financing statement or FS.

Q: Can a SI be perfected in a deposit account under current UCC Article 9?
A: Yes, a SI may be perfected in a deposit account under current UCC Article 9.

Q: Can a SI in a deposit account be perfected by filing a FS?
A: No, a SI in a deposit account may not be perfected by filing a FS.

A. **Control**. Under revised Article 9 a secured party perfects a security interest in a deposit account by obtaining "control" over the deposit account. The concept of "control" is similar to the concept of control used under Article 8 and incorporated in revised Article 9 by reference. However, in the case of deposit accounts, revised Article 9 does not incorporate the definition of control from Article 8. Instead, revised Article 9 contains its own specification of the circumstances that give a secured party control in §9-104.

B. **Filing Ineffective**. Unlike a security interest in a "securities account," the filing of a financing statement is not effective to perfect a security interest in a deposit account. Section 9-310(b)(8) provides that filing a financing statement is **not necessary** to perfect a security interest in a deposit account which is perfected by control under Section 9-314. Section 9-312(b)(1) states that a security interest in a deposit account may be perfected **only** by control under §9-314 (except to the extent of an interest in proceeds under §9-315(c) and (d)).

Q: How is a SI in a deposit account perfected?
A: A SI is perfected by the SP obtaining "control" over the deposit account.

C. **Definition**. A deposit account is a special kind of collateral with its own definition contained in §9-102(a)(29). That definition provides:

> **"(29) "Deposit account" means a demand, time, savings, passbook, or similar account maintained with a bank. The term does not include investment property or accounts evidenced by an instrument."**

1. Do not confuse the term "deposit account" with the term "account," which also is defined under revised Article 9. As defined, the term "account" specifically excludes "deposit accounts." See §9-102(a)(2)("The term does not include rights to payment evidenced by chattel paper or an instrument; commercial tort claims; deposit accounts…").

2. Another confusion to avoid is the scope of the term "investment property." Although in common usage a deposit account might be considered a form of investment, the term "deposit account" specifically excludes investment property. As a drafting matter, it would have been clearer, perhaps, to specifically exclude deposit accounts from the definition of investment

property. Elegance aside, revised Article 9 is clear that deposit accounts are not investment property.

3. Similarly, the term "general intangible" also is defined in revised Article 9 to exclude "deposit accounts." See §9-102(a)(42)("'General intangible' means any personal property, including things in action, other than…deposit accounts…").

4. And, for the avoidance of doubt, the term "Goods" is defined in revised Article 9 to exclude "deposit accounts." See §9-102(a)(44). Perhaps this exclusion was thought necessary because deposit accounts sometimes are evidenced by documents, such as passbooks, which are potentially viewed as things that are "movable when a security interest attaches."

5. Deposit accounts are included within "Cash proceeds." See §9-102(a)(9)("Cash proceeds" means proceeds that are money, checks, deposit accounts, or the like.").

6. Although revised Article 9, §9-109(d)(10), excludes from the scope of its coverage a right of recoupment or set-off, §9-340 applies with respect to the effectiveness of rights of recoupment or set-off against deposit accounts. See §9-109(d)(10).

7. An assignment of a deposit account in a consumer transaction is excluded from the coverage of revised Article 9 (other than a non-negotiable certificate of deposit) but §§9-315 and 9-322 apply with respect to proceeds and priorities in proceeds. See §9-109(d)(13).

Q: A deposit account is included within the definition of 'account' under the UCC? TRUE or FALSE?

Q: A deposit account is a kind of "cash proceeds"? TRUE or FALSE?

Q: Deposit accounts are "investment property" under the UCC? TRUE or FALSE?

Q: Deposit accounts are included within the definition of 'general intangibles under the UCC? TRUE or FALSE?

II. **Old System**. Before the Article 9 revisions, a SP perfected its SI in a deposit account under common law by taking "sole dominion and control" over the deposit account (except for those few jurisdictions that permitted perfection by filing). Great confusion existed over whether a debtor could access funds in a deposit account without destroying the SP's sole dominion and control. Some cases suggested that a SP needed possession of any indispensable instrument, such as a passbook, that evidenced the deposit account. Revised Article 9 eliminates confusion by defining 'control'. A SP may have "control" over a deposit account even if the debtor has access to the funds in the account in certain circumstances.

Q: Prior to the revisions to UCC Article 9, a SP party perfected a SI in a deposit account by obtaining "sole dominion and control" over the deposit account. TRUE or FALSE?

Q: At common law, SP might lose "sole dominion and control" over a deposit account if it allowed the debtor to have access to fuds in the deposit account. TRUE or FALSE?

Q: A SP loses 'control' over a deposit account under current UCC Article 9 if it allows the debtor to have access to funds on deposit in the account. TRUE or FALSE?

III. **New System: Control of Deposit Accounts**. Section 9-104 of revised Article 9 contains the specification of those circumstances that give a secured party control over a debtor's deposit account. That section provides:

> **(a) A secured party has control of a deposit account if:**
>
> **(1) The secured party is the bank with which the deposit account is maintained;**
>
> **(2) The debtor, secured party, and bank have agreed in an authenticated record that the bank will comply with instructions originated by the secured party directing disposition of the funds in the deposit account without further consent by the debtor; or**
>
> **(3) The secured party becomes the bank's customer with respect to the deposit account.**
>
> **(b) A secured party that has satisfied subsection (a) has control, even if the debtor retains the right to direct the disposition of funds from the deposit account.**

IV. **Analysis of Definition**. There are three methods to obtain control over a deposit account. The debtor, the deposit bank and the secured party may agree in an authenticated record that the deposit bank will follow the instructions of the secured party without further consent of the debtor. Notice that such an agreement is a three-party agreement and not simply an agreement between a deposit bank and a secured party. Such an authenticated record is generally known as a "control agreement" or a "deposit account agreement."

A. **Bank's Option**. Section 9-342 states that Article 9 does not require a bank to enter into a control agreement even if its customer so requests or directs. If a deposit bank elects to enter into a control agreement, it is not required to disclose the existence of the agreement to another person unless it is directed to do so by its customer.

B. **Retention of Rights by Debtor**. Notice that a control agreement does not need to require that the debtor give up its rights also to direct the deposit bank with respect to the disposition of funds in the deposit account. To give the secured party additional security, the secured party may negotiate with the debtor to have this exclusive right and obtain the agreement of the deposit bank to follow its instructions only. A deposit bank may be reluctant to give a secured party this exclusive right so long as the deposit

account remains in the name of the debtor. This is because of the risk of error should a bank officer follow the directions of the named party on the deposit account. To avoid any implication that control is lacking if the debtor retains the right to direct the disposition of funds, Section 9-104(b) specifically states that the retention of such a right by the debtor does not defeat control. This language was included specifically to counter the suggestion in case law that such a right was inconsistent with "sole dominion and control."

C. **Transfer of Deposit Account into Secured Party Name**. If added protection is desired, the deposit account can be transferred into the name of the secured party as an alternate method of obtaining control.

D. **Deposit Bank has Control**. Additionally, the deposit bank at which the deposit account is maintained automatically has control over the deposit account.

Q: How many different methods does the UCC provide for obtaining control over a deposit account? Describe each of these three methods.

Q: A depositor may direct its bank to sign a control agreement to perfect a SI in the deposit account which it maintains with the bank. TRUE or FALSE?

V. **Attachment**. As in the case of any security interest, the security interest in a deposit account must attach to become enforceable. To attach, the secured party must give value, the debtor must have rights in the collateral and, if the collateral is a deposit account, the security interest **may** attach when the secured party has control of the deposit account under Section 9-104 pursuant to the debtor's security agreement. See Section 9-203. As in other cases, attachment may occur prior to control if the debtor has authenticated a security agreement that provides an adequate description of the collateral.

VI. **Perfection**. Perfection of a security interest in a deposit account is governed by Section 9-314, which provides that a security interest in a deposit account **may** be perfected by control. Perfection occurs at the time that control is obtained. The security interest remains perfected only while the secured party retains control.

A. If the jurisdiction governing the deposit account (discussed below) changes, the security interest in the deposit account remains perfected until the earlier of the time at which the security interest would have become unperfected under the laws of the first jurisdiction or the expiration of a four month period after the change in jurisdiction.

VII. **Priority**. Section 9-327 governs the priority given to a security interest in a deposit account. A secured party with control has priority over a secured party without control. In general, priority among secured parties with control rank according to the time of obtaining control. The first secured party to obtain control has priority over a secured party who later obtains control. Nevertheless, the security interest of a deposit bank at which the deposit account is maintained has priority over an earlier security interest pursuant to which control is obtained via a control agreement. However, if a secured party obtains control by transferring the deposit account into its own name, then it will have priority over the security interest of the deposit bank as against the debtor. Notwithstanding the perfection of a security interest in a deposit account, the security interest may be subject to rights of set-off and to transferees of funds from the account.

A. **Rights of Set-off**. Section 9-340 provides that a bank may exercise its right of recoupment and set-off against a deposit account even though another secured party has obtained a perfected security interest in the deposit account. The priority given the deposit bank via its exercise of recoupment and set-off rights is consistent with the priority given the deposit bank for any security interest it has in the deposit account, even if another secured party obtained control via a control agreement prior to the

security interest granted to the deposit bank. The deposit bank may exercise a set-off right even if the debtor did not grant a security interest to the deposit bank. In this way, the existence of a set-off right can be seen as equivalent in effect to the grant of a security interest. The right to a recoupment or set-off is not altered by the fact that a debtor may independently grant the deposit bank a security interest. The set-off and security interest rights are cumulative and not mutually exclusive. See §9-340(b). However, the deposit bank may not exercise a set-off right against a debtor if the debtor transfers the deposit account into the name of the secured party (although it may retain a right of recoupment). See §9-340(c). The difference between a set-off and a recoupment is beyond the scope of this outline and will not be tested.

Q: If Big Bank's loan to D has a SI in a deposit account with Local Bank, and D's loan with Local Bank also has a SI in the same deposit account (both perfected), Big Bank's SI is senior to Local Bank's SI. TRUE or FALSE?

Q: If Big Bank's loan to D has a SI in a deposit account with Local Bank which was perfected by registering the account in Big Bank's name, and D's loan with Local Bank also has a SI in the same deposit account, Big Bank's SI is senior to Local Bank's SI. TRUE or FALSE?

1. **Ambiguous Wording**. The wording of §9-340(a) is somewhat ambiguous. Literally, it states that a deposit bank may exercise any right of recoupment or set-off "against a secured party that holds a security interest in the deposit account." On its face, this would seem to suggest that a deposit bank might exercise a set-off right against the deposit account in respect of a debt owed to the deposit bank by the secured party and not by the debtor. Such a reading would place a debtor at credit risk to the secured party. The instructor would read the section to simply confirm that the deposit bank can exercise a set-off right in respect of a debt owed by the debtor to the deposit bank notwithstanding the security interest granted to the secured party—in effect making clear that the interest of the secured party is junior to the recoupment and set-off rights of the deposit bank.

Q: If Big Bank's loan to D has a SI in a deposit account with Local Bank, and D's loan with Local Bank does not have a SI in the same deposit account , Local Bank may nevertheless "set-off' the amount in the account to repay Local Bank's loan (despite the security interest of Big Bank. TRUE or FALSE?

2. **Deposit Bank's Rights Unaltered**. Section 9-341 makes it clear that a deposit bank's rights are not terminated, suspended, or modified by: the creation, attachment, or perfection of a security interest in a deposit account; the bank's knowledge of the security interest; or its receipt of instructions from a third party **unless** the deposit bank otherwise agrees in an authenticated record. This means, among other things, that a deposit bank might exercise its right of set-off upon receiving instructions to disburse funds on deposit to the secured party. Also, the secured party cannot allege that the bank's mere knowledge of the security interest somehow limits the bank's rights. Notice that a secured party is free to ask a deposit bank to waive its rights of set-off by contract. Such a waiver might be included in a control agreement among the debtor, the deposit bank and the secured party. In practice, it may be difficult to get a deposit bank to agree to waive its rights of set-off.

B. **Transferee of Funds from Deposit Account**. Section 9-332(b) provides that a transferee of funds from a deposit account takes the funds free of any security interest unless the transferee acts in collusion with the debtor to violate the rights of the secured party.

C. **Conflicting Security Interests**. Section 9-322 governs conflicting interests in the same collateral. It contains the odd statement that if a security interest in a deposit account is perfected by a method other than filing (which it would be, as control is the exclusive method of perfection), then conflicting perfected security interests in proceeds of the collateral rank according to priority in time of filing. Thus, even though a secured party may be relying exclusively on a deposit account as collateral (for which no filing is necessary or effective), a filed financing statement referring to other types of Article 9 collateral might be useful to protect the secured party's interest. Such a filing does not apply to proceeds that are cash proceeds, chattel paper, negotiable documents, instruments, investment property, or letter-of-credit rights.

Q: Assume Big Bank has a perfected SI in a deposit account, but Debtor writes a check to pay a supplier. Big Bank's SI continues in the funds. TRUE or FALSE?

1. **Example**. In a typical secured syndicated loan transaction, the secured party would have obtained a blanket lien on all assets of the debtor and filed financing statements. If two secured lenders had control over a debtor's deposit accounts and those deposit accounts where used to acquire inventory or equipment, the priority in these proceeds would be given to the secured party who first filed a financing statement that covered the proceeds (unless, perhaps, if the amount on deposit could be traced to an advance by one of the secured lenders which qualified as funding of the purchase price of equipment or inventory which had PMSI status).

Q: Assume BB filed a FS at T1 covering D's equipment. LB filed a FS at T2 also covering D's equipment. Assume both have enforceable SI's in equipment. LB first perfected a SI in D's deposit account. BB later obtained a SI in the same deposit account via a control agreement. D then used funds in the deposit account to purchase new equipment. Who has priority in the equipment? Big Bank (BB) or Local Bank (LB)?

VIII. **Governing Law**. The local law of the deposit bank's jurisdiction governs the perfection, the effect of perfection or nonperfection and the priority of a security interest in a security interest maintained with that bank. See §9-304(a). The local law of the deposit bank's jurisdiction does not need to govern the creation of the security interest (though it may). As a practical matter, a single security agreement governed by the law of a single jurisdiction may create a security interest in numerous deposit accounts maintained at banks in a variety of jurisdictions across the United States.

A. **Rules Determining Bank's Jurisdiction**. Section 9-304(b) contains the rules for determining a deposit bank's jurisdiction. The debtor and the deposit bank may specify by agreement the jurisdiction of the deposit bank. If they have done so, then that jurisdiction is the bank's local law jurisdiction. If they have not done so, they may provide by agreement that a particular law governs the deposit account. If they have done so, then that jurisdiction will be the deposit bank's local law. If no such agreement has been reached, then the deposit bank's jurisdiction will be the jurisdiction specified by agreement as the jurisdiction of the office at which the account is maintained. If such an agreement does not exist, then the local law jurisdiction is the one identified in the account statement as the office serving the

account. If none of these specifications or agreements is made, then the deposit bank's local law jurisdiction is the jurisdiction in which the chief executive office of the bank is located.

B. **Practical Tip**. In any transaction, it would be ideal to have the deposit bank agree with the debtor at the time a control agreement is signed on the jurisdiction to govern the deposit account. It would seem that this must be an agreement between the debtor and the deposit bank (and not simply a confirmation by the deposit bank to the secured party). A secured party also might consider obtaining a representation and warranty from the debtor and the deposit bank as to the local law governing the deposit account. Whereas a debtor may be willing to make such a representation, a deposit bank may be reluctant to incur any additional liability to a secured party and simply may tell the secured party to make its own investigation of the documentation. Similarly, a secured party may wish to obtain a covenant from the debtor that it will not change its agreement on jurisdiction with the deposit bank without notice and consent of the secured party.

IX. **Remedies**. Section 9-607 provides that, following a default, a secured party that also is the deposit bank may apply funds in the deposit account to satisfy the secured obligation. Following a default, a secured party, not the deposit bank, that has obtained control by either a control agreement or by transferring the account into the name of the secured party may instruct the deposit bank to pay the balance on deposit to or for the benefit of the secured party.

A. **Drafting**. The debtor and the secured party **may** agree that the secured party can apply funds on deposit in the deposit account to the secured obligation prior to a default. This section does **not** expressly state that the agreement must be contained in an authenticated record. However, the best practice would be to include any such agreement in a written security agreement.

X. **Release of Control and Collateral**. When the obligation owed to the secured party has been paid (or the secured party is otherwise not committed to make advances, incur obligations or otherwise give value), the secured party is required, upon notice from the debtor, to relinquish control over the deposit account within 10 days after receiving an authenticated demand from the debtor.

A. **Control by a Control Agreement**. If the secured party has control over the deposit account by virtue of a control agreement pursuant to which the deposit bank has agreed to follow the directions of the secured party, the secured party must send the deposit bank a notice indicating that the deposit bank no longer must follow the directions of the secured party. See Section 9-208(b)(1).

B. **Control by Registration**. If the secured party has control over the deposit account by virtue of the transfer of the deposit account into the name of the secured party, the secured party must either pay the balance on deposit in the account to the debtor or transfer the balance on deposit into a deposit account in the debtor's name.

1. **Other Methods of Transfer**. As written, the statute would not seem to permit the secured party to transfer the balance to a securities account in the name of the debtor (unless such a transfer could be seen as a payment of the balance to the secured party). In any case, it is hard to see how such a transfer to a securities account could result in liability to the secured party (unless the securities intermediary becomes insolvent and the deposit account would have been Federally insured).