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From Property to Contract and Back: An Examination of Deposit Accounts and Revised Article 9

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INTRODUCTION

Bank accounts originated with seventeenth-century goldsmiths located in London's Lombard Street.1 Gold was then an index of wealth but presented storage problems—especially after Charles I raided the traditional gold repository, the Tower of London, in 1640 for an involuntary loan of £200,000. Goldsmiths provided a solution: since they handled and stored gold everyday, they offered, for a fee, safe storage of the gold and agreed to return it to the customer upon his request. This relationship between goldsmith and client was thus one rooted in property concepts; title to the gold remained with the customer, and the goldsmith was a caretaker—technically, a bailee—of the metal.2

Wealth, however, is not useful unless it can be used or spent. The owners of gold realized this and also realized it was a nuisance to send down to the goldsmiths for a little gold every now and then to settle debts or to purchase goods. So instead they gave their creditors and vendors documents containing directions, or orders. These documents were addressed to the goldsmiths and directed them to deliver some of the gold on deposit to the bearer of the document. These documents were the forerunners of today's checks.3

The system, however, was still rooted in property concepts; the goldsmith still did not "own" the gold.4 But goldsmiths were not dumb; they realized they controlled a tremendous store of fungible wealth that could be converted into other assets, such as loans. So long as they were judicious as to whom they lent the gold, and kept such reserves of gold as were necessary to pay the documents

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2. "The owner of a chattel may give to another person possession of the chattel without giving him the title to the chattel. In such a case a bailment and not a trust is created." RESTATEMENT (SECOND) OF TRUSTS § 5 cmt. a (1959). Bailments were recognized by common law courts long before trusts were recognized by equity courts. See id.
3. See FARNSWORTH, supra note 1, at 53.
4. See sources cited supra note 2.
received, everyone was better off.5

This step, however, changed the complexion and the status of the relationship between the goldsmith and his customers. Instead of bailment, the relationship became one of debtor and creditor. Upon transfer of the gold, the goldsmith simultaneously became the owner of the gold and a creditor of the customer for its value. Contract rules, such as they were, governed the rights and responsibilities of the two parties.6

Thus, the bank account evolved from a property-based concept into a contract relationship. Under the modern version of this contract, banks take title to the funds given them and become debtors; depositors become creditors of the banks with respect to the amount of such funds.7 In accordance with separate agreements, entered into against the background of Article 4 of the UCC, the depositary bank is obligated to pay out on its customer's orders, or checks.8 In the meantime, banks lend the money transferred to them.

Bank accounts are vital to the economy in several respects. First, they are valuable and secure, since we treat the person obligated on the account—the bank—very differently in our legal system than other debtors. Banks are regulated separately for safety and soundness.9 They even have their own insolvency system,10 which can

5. See FARNSWORTH, supra note 1, at 52.
6. See id.
8. Although the terms of this agreement may vary from contract to contract, the default rules are set out in Part 4 of Article 4 of the Uniform Commercial Code. See 1 BARKLEY CLARK & BARBARA CLARK, THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS § 3.01[1] (rev. ed. 1999). The principle obligation of a bank is to pay on all checks which are "properly payable." See U.C.C. § 4-401.
10. See, e.g., 12 U.S.C. § 192 (giving comptroller of currency power to control national
act with blinding quickness should there be some flaw in the creditworthiness of a bank.\textsuperscript{11} Second, bank accounts are the lifeblood of commerce. Every business has at least one, if not more, and relies on their efficacy in conducting daily business.\textsuperscript{12} To cut out deposit accounts would be to cut out the very heart of business.

Such a valuable asset has other charms. Just as the goldsmiths of Lombard Street realized that they could enhance their wealth by lending the gold entrusted to them, modern debtors realize that they might be able to leverage their wealth by borrowing against their deposit accounts. As originally adopted, however, Article 9 excluded deposit accounts from its coverage as initial, or original, collateral.\textsuperscript{13} To give force to the other provisions of Article 9, however, its drafters brought deposit accounts within Article 9 to the extent they represented proceeds of collateral within the scope of Article 9.\textsuperscript{14} The common law outside of Article 9 continued to govern original security interests in deposit accounts.\textsuperscript{15}

banking association in default). Banks are ineligible to file for relief under federal bankruptcy law. \textit{See} 11 U.S.C. §§ 109(b)(2) (stating that banks and other financial institutions may not be debtors under chapter 7 of Bankruptcy Code), 109(d) (1994) (conditioning eligibility to file under chapter 11 on eligibility to file under chapter 7).

11. \textit{See}, e.g., FDIC v. Bank One, Waukesha, 881 F.2d 390, 394 (7th Cir. 1989) ("Often the first that depositors know of the failed bank’s trouble is the announcement of the [purchase and assumption] and the erection of the new owner’s sign over the door."). The lawsuits leading to these seizures are initiated without notice to the bank’s owners, and thus the owners typically find out about the closure at the same time the depositors do. \textit{See}, e.g., Fuentes v. Shevin, 407 U.S. 67, 91-92 (1972) (noting summary seizure of property is permitted “to protect against the economic disaster of a bank failure”); Fahey v. Mallonee, 332 U.S. 245, 253-54 (1947) (recognizing that suspension of usual procedure is not unconstitutional given “history and customs of banking”).

12. As one indication of the centrality of bank deposits, approximately $371 billion dollars were held in demand deposit accounts in the United States at the beginning of 1999. \textit{See} Federal Reserve Statistical Release (May 20, 1999 update) <http://www.bog.frb.fed.us/releases/H6/Current/>. Another $246 billion was held in “other checkable deposits” such as Negotiable Order of Withdrawal accounts. \textit{See id.}

In making these observations, I have broken out the demand deposit account data from M1, a larger measure of money supply, since M2 and other measures include money market accounts which, under Revised Article 9, would be treated as investment property. \textit{See R. § 9-102 cmt. 12.}


14. \textit{See id.} The specific treatment of deposit accounts as proceeds was found in section 9-306(2), which gave a right to identifiable proceeds, and in section 9-306(3)(b), which deemed the secured party to be perfected in such deposit accounts so long as the proceeds were “identifiable.”

For the last decade, Article 9 has been undergoing revision.\textsuperscript{16} The final product has now been approved by its two caretakers, the American Law Institute and the National Conference of Commissioners for Uniform State Law.\textsuperscript{17} Its text and accompanying comments have been sent to the states for adoption, with a target date of July 1, 2001 for its effectiveness.\textsuperscript{18}

Revised Article 9 makes many changes, and with respect to bank accounts—which Revised Article 9 calls “deposit accounts”—the changes are significant. Following the lead of many commentators\textsuperscript{19} and reversing prior law, Revised Article 9 includes deposit accounts within its scope, at least to the extent that they are not primarily deposit accounts held by consumers.\textsuperscript{20} Especially in the way this concept has been implemented in Revised Article 9, we thus have somewhat of a return to a property concept. The contractual relationship between bank and customer is now property that the customer may fully encumber, and an authority no less that Revised Article 9 will govern the scope, attachment, perfection, priority, and enforcement of such interests.

\textsuperscript{16} In 1990, the Permanent Editorial Board for the UCC with the support of its sponsors, The American Law Institute and the National Conference of Commissioners on Uniform State Laws, established a committee to study Article 9 of the UCC. The study committee issued its report as of December 1, 1992, recommending the creation of a drafting committee for the revision of Article 9 and also recommending numerous specific changes to Article 9.

\textsuperscript{17} The American Law Institute approved Revised Article 9 at its May 1998 meeting, and the National Conference of Commissioners on Uniform State Laws followed with their approval at their July 1998 meeting. See R. § 9-101 cmt. 2.

\textsuperscript{18} Revised section 9-701 provides that Revised Article 9 is to take effect on July 1, 2001. This delayed effective date will allow private parties to adjust their practices and the private bar to become familiar with the new terms. See id. § 9-701 cmt.


\textsuperscript{20} See infra Part II.A.2.
After briefly reviewing the current law, this article examines these new provisions, trying to describe how they are intended to work. The article next examines how parties will likely adapt their current lending and commercial practices to adapt to Revised Article 9. It concludes with an analysis of some potential problems and policy shifts these changes will likely bring about.

I. CURRENT LAW

A. Exclusion as Original Collateral—UCC Section 9-104(l)

When Article 9 was drafted, the comments acknowledged that "[r]ights under ... deposit accounts[] are often put up as collateral." Nevertheless, the drafters thought that "[s]uch transactions are often quite special, do not fit easily under a general commercial statute and are adequately covered by existing law." This led to section 9-104(l)'s exclusion of deposit accounts as original collateral.

B. Inclusion as Proceeds Collateral

The drafters also realized that deposit accounts could not be wholly excluded from a sensible secured transactions law. Other collateral—equipment, inventory, and accounts—are often sold and the proceeds deposited with a bank. Unless the secured party's interest was to stop at the banker's door, recourse to deposit accounts, at least to the extent they could be said to contain proceeds, was imperative.

Article 9 recognized this and specifically included deposit accounts "as provided with respect to proceeds (Section 9-306) and priorities in proceeds (Section 9-312)." Section 9-306, in turn, extended Article 9 to deposit accounts, but only to the extent that such accounts contained "identifiable proceeds." Identifiability had an added benefit under the original version of Article 9—no extra measures to continue perfection in the proceeds in the bank account

22. Id.
23. Although authority is scarce, some sources suggest that the drafters excluded deposit accounts largely for political reasons due to strong opposition by banking interests. See 1 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 10.7, at 315-16 (1965); Greene, supra note 15, at 261 n.4.
24. U.C.C. § 9-104(1).
25. See id. § 9-306(2). Under Article 9, a right in proceeds arises automatically unless the parties have agreed otherwise. See id. § 9-203(3).
were necessary so long as the proceeds were "identifiable cash proceeds." 26

The question of how to identify portions of a seemingly indivisible obligation—the bank's contractual obligation to pay funds upon receipt of its customer's order—initially bedeviled commentators and courts. Grant Gilmore, the principal drafter of Article 9, weighed in early with the belief that no proceeds could be identified in any account into which both proceeds and nonproceeds had been deposited. 27 Although at least one court followed this, 28 most did not. 29 The trend settled on the lowest intermediate balance rule for sorting out the parts of the deposit account attributable to proceeds; or put technically, courts adopt the lowest intermediate balance rule to "identify" portions of the deposit account for purposes of section 9-306(3)(b). 30

Under the lowest intermediate balance rule, a court recreates the

26. See id. § 9-306(3)(b). This applied, however, only if a "financing statement cover[ed] the original collateral." 2d id. As a consequence, proceeds from the sale of consumer goods subject to a purchase money security interest for which no financing statement was filed could not be perfected under this subsection (financing statements are not necessary to perfect such an interest, see id. § 9-302(1)(d)).


28. See Morrison Steel Co. v. Gurtman, 274 A.2d 306, 310 (N.J. Super. Ct. App. Div. 1971). In addition, in In re Littleton, the Bankruptcy Appellate Panel declined to apply an equitable tracing rule because the secured creditor allowed the debtor to commingle proceeds in a general operating account instead of enforcing its contractual right to have the debtor deposit such amounts in a segregated account. See 106 B.R. 632, 636 (B.A.P. 9th Cir. 1989).


30. As stated by the Iowa Supreme Court, the adoption of a supplementary principle such as the equitable lowest intermediate balance test is consistent with UCC section 1-103. See C&H Farm. Serv. v. Farmers Sav. Bank, 449 N.W.2d 866, 877 (Iowa 1989); see also First Nat'l Bank v. Martin (In re Martin), 25 B.R. 25, 27-28 (Bankr. N.D. Tex. 1982) ("The rules pertaining to the rights of a secured creditor to trace the proceeds of his secured collateral are liberally construed in favor of the creditor as evidenced by the extension of the tracing method known as the 'intermediate balance rule' into the area of commercial law."); Ex Parte Alabama Mobile Homes, Inc., 468 So.2d 156, 160 (Ala. 1985) ("The rules employed to distinguish the identifiable proceeds from other funds are liberally construed in the creditor's favor by use of the 'intermediate balance rule.'").

Under the lowest intermediate balance rule, courts have required the secured party to bear the burden of tracing the funds into the account and recreating the lowest intermediate balance. See, e.g., In re Oriental Rug Warehouse Club, Inc., 205 B.R. 407, 412-13 (Bankr. D. Minn. 1997); Chrysler Credit Corp. v. Superior Court, 22 Cal. Rptr. 2d 37, 41-42 (Cal. Ct. App. 1993).
daily balances in the disputed account, noting when deposits were made and the sources of those deposits. It then applies the presumption that the debtor will spend his or her own money first, "leaving" the secured party's proceeds portion behind for the secured party. The secured party then gets the lowest balance of "pure" proceeds during the relevant time.\(^3\)

In addition to using these rules for resolving disputes among consensual secured parties, courts also used these rules to determine the relative priorities of secured parties against lien creditors' garnishments\(^3\) and against tax liens.\(^3\) A key area of dispute, however, was the relative rights of a secured party with identifiable proceeds and the setoff rights of the bank holding the deposit. In these cases, the secured party generally prevailed.\(^3\)

C. The Rogue States and Reform

Against this background, some states did not see the wisdom of excluding deposit accounts. They enacted nonuniform amendments to their versions of the Uniform Commercial Code and brought deposit


33. See, e.g., Trust Co. v. United States, 735 F.2d 447, 449-50 (11th Cir. 1984). But see Peoples Nat'l Bank v. United States, 777 F.2d 459, 461-62 (9th Cir. 1985) (citing Trust Co., but holding for IRS because bank had not taken steps necessary under Washington common law to perfect its interest in deposit account).

Treasury regulations under the Federal Tax Lien Act recognize security interests in proceeds, at least to the extent that attachment of the original collateral occurred within 45 days of the filing of the lien and to the extent recognized under state law. See 26 C.F.R. § 301.6323(c)-1(f), example 1(ii) (1998) ("The priority of X's security interest also extends to the proceeds, received on or after the 46th day after the tax lien filing, from the liquidation of the accounts receivable and inventory held by M on [the date 45 days after the filing of the tax lien], if X has a continuously perfected security interest in identifiable proceeds under local law.").

With respect to contests between the IRS and secured parties as to insurance proceeds, courts have favored the secured parties. See, e.g., Paskow v. Calvert Fire Ins. Co., 579 F.2d 949, 952-54 (5th Cir. 1978); PPG Indus., Inc. v. Hartford Fire Ins. Co., 531 F.2d 58, 60-61 (2d Cir. 1976).

accounts into Article 9. When lending in these states—California, Hawaii, Idaho, Illinois, and Louisiana—did not crumble, interest was sparked in including deposit accounts into any revision of Article 9.

The Permanent Editorial Board Report, which preceded the drafting of Article 9, recommended the addition of deposit accounts as permissible original collateral to Article 9. This report adopted the recommendations of a task force that deposit accounts should be brought into Article 9. It also evinced a great concern for banks should non-bank secured parties seek to establish perfected security interests in deposit accounts, stating that no duties should be owed to a secured creditor claiming an interest in a deposit account “unless, and then only to the extent that, the institution [holding the account] agrees to assume such duties or is served with legal process concerning the deposit account.” The report simply noted that “serious consideration” should be given to the report’s other recommendations, but that the task force’s recommendations on enforcement by non-bank secured parties “may unnecessarily impede the flow of funds through the payment system.”


Under section 9302(1)(g), perfection is automatic upon attachment when the secured party is the depositary bank, see CAL. COM. CODE § 9302(1)(g)(i), and by notice to the depositary bank when the secured party is not the bank maintaining the account, see id. § 9302(1)(g)(ii).


38. See 810 ILL. COMP. STAT. 5/9-302(1)(i) (West 1997). Illinois follows generally the California perfection scheme, but additionally requires that the organization notified “provide[] written acknowledgement of and consent to the notice of the secured party.” Id. 5/9-302(1)(i)(ii).

39. See LA. REV. STAT. ANN. § 10:9-305(4) (West 1993 & Supp. 1999). Louisiana follows the California scheme and makes it clear that filing a financing statement is ineffective: “The filing of a financing statement is not necessary or effective to perfect a security interest in a deposit account.” Id.

40. To this list one might add Oklahoma, whose 1994 nonuniform amendment to section 9-105(e) redefined certificates of deposit in such a way that most deposit accounts would be certificates of deposit and, hence, within Article 9 notwithstanding section 9-104(l). See Sepinuck, Defense, supra note 19, at 479 n.7.

41. See PEB STUDY, supra note 16, at 68-71.

42. Id. at 68. The task force had recommended that non-bank secured parties be able to perfect their interest in a deposit account simply by filing a financing statement. See id. at 70.

43. See id. at 68.

44. Id. at 71.
II. STRUCTURE OF REVISED ARTICLE 9

Revised Article 9 does not specifically state that deposit accounts may be used as Article 9 collateral. Rather, Revised Article 9 broadly includes all personal property within its scope and relies on characterization by non-UCC law of such accounts as personal property to bring deposit accounts within its scope. In addition, Revised Article 9 carries forward existing Article 9's treatment of such accounts as within Article 9 to the extent that they represent proceeds of other Article 9 security interests. This part examines this dual treatment—as original collateral and as proceeds collateral—with respect to the basic elements of secured transactions: coverage, attachment, perfection, priority, duties and privileges, and enforcement.

A. Coverage

As indicated earlier, existing Article 9 covers deposit accounts to the extent that they constitute proceeds of other collateral. Revised Article 9 continues this treatment and expands it to cover deposit accounts as original collateral.

1. Definition of “Deposit Account”—Revised Section 9-102(a)(29)

First, the basics. Revised Article 9 defines a “deposit account” as “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.” This brings the definition of deposit account substantially in accord with the definition of the

45. Revised Article 9 does exclude certain consumer deposit accounts. See R. § 9-109(d)(13); infra Part II.A.2.
46. See supra Part I.B.
47. R. § 9-102(a)(29). “Bank,” in turn, is defined in Revised section 9-102(a)(8) as “an organization that is engaged in the business of banking. The term includes savings banks, savings and loan associations, credit unions, and trust companies.” This change substantially conforms the definition of “bank” to that used in Article 4 of the UCC. See U.C.C. § 4-105(1). The only difference is that under the definition of “bank” in Revised Article 9, individuals cannot be banks, while under Article 4 they may be banks. Compare id. (“Bank means a person engaged in the business of banking, including a savings bank, savings and loan association, credit union, or trust company.” (emphasis added)) with R. § 9-102(a)(8) (“Bank means an organization that is engaged in the business of banking. The term includes savings banks, savings and loan associations, credit unions, and trust companies.” (emphasis added)). Under UCC section 1-201(30), applicable to Revised Article 9 through Revised section 9-102(c), “person”—the term used in Article 4—is broader than “organization”—the term used in Revised Article 9.
cognate term "account" in Article 4. It focuses on the debtor-creditor nature of the relationship between a bank and its customer through its incorporation of the general term "account," which although under Revised Article 9 does not include "deposit account," generally means "a right to payment of a monetary obligation, whether or not earned by performance."

The initial focus then will be whether a bank owes a "right of payment" to its customer. Generally, this type of obligation will be found in Article 4, but other similar obligations may arise under federal banking law. Once such a "right to payment" exists, however, it will constitute a deposit account only to the extent that it is similar to "a demand, time, savings, passbook [account]." In questionable cases, therefore, the inquiry will be into the particular practices in the banking industry.

The definition's specific exclusion of "investment property" and "accounts evidenced by an instrument" is designed to cope with common situations. Cash management accounts held by brokers, for example, may look like checking accounts, since they give individuals checks that can be used to draw on balances maintained with the broker, but they are instead investment property under Revised Article 9. As such, they are excluded from the definition of "deposit account." Similarly, the status of the certificate of deposit caused some trouble under Former Article 9, especially the nonnegotiable or uncertificated certificate of deposit.

48. Under Article 4, an "account" is defined as "any deposit or credit account with a bank, including a demand, time, savings, passbook, share draft, or like account, other than an account evidenced by a certificate of deposit." U.C.C. § 4-104(a)(1).
49. See R. § 9-102(a)(2).
50. Id.
51. Id. § 9-102(a)(29).
52. This is confirmed by the comments: "Thus, the term also does not include shares in a money-market mutual fund, even if the shares are redeemable by check." Id. § 9-102 cmt. 12.
53. The definition of "investment property" is essentially the same in Revised Article 9 as it was under the 1995 version of Article 9. Compare U.C.C. § 9-115(1)(f) with R. § 9-102(a)(49).

The problem was noted as early as 1981. See Steven L. Harris, Non-Negotiable Certificates...
such an account qualifies as an instrument, it will be treated as a deposit account, thus clarifying this area of the law.

The difference in treatment will be seen later but essentially boils down to differences in the effective methods of perfection. Under Revised Article 9, a secured party may file to perfect its security interest in investment property or in an instrument; however, filing is completely irrelevant to perfecting a security interest in a deposit account.

2. As Original Collateral in Non-Consumer Secured Transactions—Revised Section 9-109(d)(13)

Section 9-109 of Revised Article 9 is broad in scope. It states that, with specific exceptions, Revised Article 9 applies to "a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract." Thus, to the extent that a deposit account is "personal property," it is presumptively within Revised Article 9's coverage. This is confirmed by the comments:


Revised Article 9 does not substantially change the definition of "instrument" from that found in Current Article 9. Compare Revised section 9-102(a)(47):

"Instrument" means a negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment. The term does not include (i) investment property, (ii) letters of credit, or (iii) writings that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card;

with UCC section 9-105(1)(i):

"Instrument" means a negotiable instrument (defined in Section 3-104), or any other writing which evidences a right to the payment of money and is not itself a security agreement or lease and is of a type which is in ordinary course of business transferred by delivery with any necessary indorsement or assignment. The term does not include investment property.

This again is confirmed by the comments:

The revised definition clarifies the proper treatment of nonnegotiable or uncertificated certificates of deposit. Under the definition, an uncertificated certificate of deposit would be a deposit account (assuming there is no writing evidencing the bank's obligation to pay) whereas a nonnegotiable certificate of deposit would be a deposit account only if it is not an "instrument" as defined in this section (a question that turns on whether the nonnegotiable certificate of deposit is "of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment.")

R. § 9-102 cmt. 12.

See id. § 9-312(a).

See id. § 9-312(b)(1) ("[A] security interest in a deposit account may be perfected only by control under Section 9-314 . . . .").

Id. § 9-109(a)(1).

See Duncan Box & Lumber Co. v. Applied Energies, Inc., 270 S.E.2d 140, 145-46 (W.
"Deposit accounts may be taken as original collateral under this Article." The consequence of this inclusion is that deposit accounts may be used as original collateral, without the need to ensure that they constitute, in some way, proceeds of other Article 9 collateral. An asset-based lender, for example, may now confidently include deposit accounts in its security agreement and, to the extent it takes the required steps to perfect, may count that asset as part of its collateral.

There is one exception and it is significant. Section 9-109(d)(13) contains a specific exclusion for certain types of deposit accounts held by consumers. It states that Revised Article 9 does not extend to "an assignment of a deposit account in a consumer transaction." The import of this exclusion is simply to remove one class of deposit accounts—those arising in a "consumer transaction"—from Article 9's coverage of original collateral. The exclusion does not change existing law with respect to coverage of consumer deposit accounts to the extent that they constitute "proceeds" of other Article 9 collateral, or to the extent that a secured party employs non-Article 9 methods to encumber the account.

"Consumer transaction," in turn, is also defined. Under section 9-102(a)(26), a consumer transaction is defined as

a transaction in which (i) an individual incurs an obligation primarily for personal, family, or household purposes, (ii) a security interest secures the obligation, and (iii) the collateral is held or acquired primarily for personal, family, or household purposes. The term includes consumer-goods transactions.

Va. 1980), for a discussion of the status of a deposit account as personal property outside of Article 9. See also Cartwright v. Deposit Guar. Nat'l Bank, 675 So. 2d 847, 847 (Miss. 1996) ("[F]unds on deposit are in the nature of intangible property and therefore subject to garnishment.").

61. R. § 9-109 cmt. 16.
62. Id. § 9-109(d)(13).
63. See U.C.C. § 9-104(l); R. § 9-109(d)(13).

Although Revised Article 9 excludes certain consumer deposit accounts, this exclusion is not preemptive; a lender may still attempt to obtain a security interest under other, non-UCC law. See id. § 9-109 cmt. 16.

64. R. § 9-102(a)(26). A "consumer-goods transaction" is defined in Revised section 9-102(a)(24) as "a consumer transaction in which: (A) an individual incurs an obligation primarily for personal, family, or household purposes; and (B) a security interest in consumer goods secures the obligation." To complete the cycle, "consumer goods" are defined in Revised section 9-102(a)(23) as "goods that are used or bought for use primarily for personal, family, or household purposes."

The main difference between a "consumer transaction" and a "consumer-goods transaction" would appear to be that a "consumer transaction" need not involve a security interest in consumer goods; some other classification of collateral could be involved. That distinction is critical for deposit accounts since they are not "goods" and, thus, would not qualify
Note that the three elements of this definition are conjunctive; all three have to be present for exclusion of the deposit account. As a consequence, if a sole proprietor grants an interest in her personal deposit account to secure her business line of credit, the fact that the personal account was held primarily for personal, family, or household purposes would not matter; the lender's security interest would attach to the deposit account since the obligation secured—the business line of credit—was not incurred primarily (or at all) for personal, family, or household purposes.

3. As Proceeds—Revised Section 9-109

To the extent that a deposit account represents or contains "proceeds" of nondeposit account collateral, those proceeds are covered by Revised Article 9 regardless of whether a consumer transaction is involved. Revised section 9-109(d)(13) specifically states that even in a consumer transaction "Sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds."65

This broad coverage as to proceeds, however, assumes that the deposit account can be seen as "proceeds." Under Revised Article 9, proceeds include "whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral" and "whatever is collected on, or distributed on account of, collateral."66 Moreover, proceeds do not stop at the first transformation; proceeds of proceeds continue to be included in the general concept of "proceeds."67

As a consequence, when collateral is sold, the money or checks received by the seller are proceeds and, when they are delivered to a bank for deposit in a deposit account, that deposit account also as "consumer goods." Therefore, a transaction involving the grant of a security interest in a deposit account could never be a "consumer-goods transaction."

65. Id. § 9-109(d)(13).
66. Id. § 9-102(a)(64)(A)-(B). The full definition is as follows:
(64) "Proceeds" means the following property:
(A) whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral;
(B) whatever is collected on, or distributed on account of, collateral;
(C) rights arising out of collateral;
(D) to the extent of the value of collateral, claims arising out of the loss, nonconformity, or interference with the use of, defects or infringement of rights in, or damage to, the collateral; or
(E) to the extent of the value of collateral and to the extent payable to the debtor or the secured party, insurance payable by reason of the loss or nonconformity of, defects or infringement of rights in, or damage to, the collateral.

67. See id. §§ 9-203(f), 9-315(a)(2).
becomes proceeds of the original secured party's security interest. But to what extent? If a debtor has $100,000 of unencumbered balances on deposit and then deposits a $100 check representing the sale of collateral, how does one divide the indivisible obligation the bank holds to pay out funds on demand?

The common law (and the equity courts) faced this issue in other contexts and developed tracing rules.\textsuperscript{68} These rules created presumptions as to which part of the account balance belonged to the holder of the account and which part did not. Although somewhat result-oriented towards nonholder claimants (as they were typically the victims of fraud or worse), these rules were picked up by courts interpreting Article 9 and applied to divvy up a deposit account under Article 9.\textsuperscript{69}

Revised Article 9 does not disturb the common law in this respect. It states that proceeds include deposit accounts "to the extent that the secured party identifies the proceeds by a method of tracing, including application of equitable principles, that is permitted under law other than this article with respect to commingled property of the type involved."\textsuperscript{70} As the comments indicate, "[t]he 'equitable principles' . . . may [include] the 'lowest intermediate balance rule.'"\textsuperscript{71}

The "lowest intermediate balance rule," apparently adopted by a majority of jurisdictions, does yield clear results if the facts are clear.\textsuperscript{72} Yet by leaving the common law undisturbed, this section permits, and indeed encourages, variances to develop among the states, depending on the maturity and availability of such other law.\textsuperscript{73}

\textsuperscript{68} See supra note 29. For a good description of the adoption of equitable tracing rules into the mainstream of commercial law, see Barnes, supra note 27, at 292-306.

\textsuperscript{69} See Barnes, supra note 27, at 296-306. For several cases using section 1-103 to justify adoption of such equitable principles, see Ex Parte Alabama Mobile Homes, Inc., 468 So. 2d 156, 159-60 (Ala. 1985); and C&H Farm Service v. Farmers Savings Bank, 449 N.W.2d 866, 877 (Iowa 1989).

\textsuperscript{70} R. § 9-315(b)(2).

\textsuperscript{71} Id. § 9-315 cmt. 3.


\textsuperscript{73} See infra Part IV.E.

Revised Article 9 eliminates Former UCC section 9-306(4), which attempted to deal with priority to proceeds of a deposit account differently upon the commencement of an insolvency proceeding. Wisely bowing to possible federal preemption claims, the comments indicate that under Revised Article 9 "the debtor's entering into bankruptcy does not affect a secured party's right to proceeds." R. § 9-315 cmt. 8.
4. Choice of Law—Revised Section 9-304

Not all states will adopt Revised Article 9 at the same time. Moreover, as indicated in the last section, Revised Article 9 anticipates that the non-UCC law of states will factor into whether a deposit account consists of identifiable proceeds. For these reasons, and possibly others, it will be important to know which state’s law governs attachment and perfection of interests in deposit accounts.

In response, the drafters have added a special section on choice of law for deposit accounts. Revised section 9-304(a) states that “[t]he local law of a bank’s jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a deposit account maintained with that bank.” This adopts a rule that is easy to apply: simply look to the jurisdiction of the bank holding the deposit account and apply that local law.

In most cases, this will likely be enough direction to settle disputes. To avoid disputes, however, most banks will look to the remaining provisions of Revised section 9-304, which provides a waterfall of options. The first option is the one that will likely be used most: “If an agreement between the bank and the debtor governing the deposit account expressly provides that a particular jurisdiction is the bank’s jurisdiction for purposes of this part, this article, or [the Uniform Commercial Code], that jurisdiction is the bank’s jurisdiction.” This provides maximum party autonomy and is to take preference over the UCC’s general choice of law validator, that of a “reasonable relationship.” This is the intended result, as the comments make clear: “The parties’ choice is effective, even if the jurisdiction whose law is chosen bears no relationship to the parties or the transaction.” This party autonomy is also flexible; it “permits the parties to choose the law of one jurisdiction to govern perfection and priority of security interests and a different governing law for other purposes.”

If the parties do not choose a jurisdiction in their agreement,

74. It may also be the case that parties in international transactions with non-U.S. debtors will use domestic United States deposit accounts as collateral. This could be the case, for example, in international project finance or securitization. A pointer to the law applicable to the deposit account is useful helpful in these cases as well.
75. R. § 9-304(a).
76. Id. § 9-304(b)(1).
77. U.C.C. § 1-105(1).
78. R. § 9-304 cmt. 2.
79. Id.
Revised section 9-304 provides an exhaustive list of pointers. If the UCC is not referred to in an agreement between the bank and the debtor, then any other choice of law clause between the bank and its customer (which need not be the debtor) suffices as a locator of the law of the bank's jurisdiction. If there is no choice of law clause in the agreement between the bank and its customer, then one looks to any designation as to where the bank will maintain the deposit account, and if that does not produce a state, then to the specification of the office servicing the account contained in any bank statements related to the account. Finally, if all else fails, one looks to the location of the bank's chief executive office.

**B. Attachment—Revised Section 9-203**

Under both Current and Revised Article 9, a security interest must "attach" to be enforceable against the debtor. Under Current Article 9, attachment consists of three basic elements: the debtor's having an interest in the collateral; value having been given; and either possession of the collateral by the secured party pursuant to an agreement or a written security agreement in which the collateral is adequately described. Security interests in identifiable proceeds are automatic. Revised Article 9 carries this treatment over to deposit accounts fairly intact.

1. Original Collateral—Revised Section 9-203(b)

For a security interest to attach to a deposit account as original collateral, Revised Article 9 requires the debtor to have an interest in the collateral and value to have been given. The third requirement—

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80. For some forms of perfection, especially with "blocked" accounts, the secured party may wish to become the bank's customer as this will enable it to have priority over the bank holding the deposit account. See id. § 9-327(4).
81. See id. § 9-304(b)(2).
82. See id. § 9-304(b)(3).
83. See id. § 9-304(b)(4).
84. See id. § 9-304(b)(5).
85. See U.C.C. § 9-203(1).
86. See id. § 9-203(3).
87. See R. § 9-203(b)(1)-(2). A debtor's rights need not be absolute and exclusive, thus allowing banks to take interests in joint deposit accounts. See Comment 6 to Revised 9-203, which provides:

A debtor's limited rights in collateral, short of full ownership, are sufficient for a security interest to attach. However, in accordance with basic personal property conveyancing principles, the baseline rule is that a security interest attaches only to whatever rights a debtor may have, broad or limited as those rights may be.
possession or a written security agreement—has been modified to conform to the nature of deposit account collateral.\textsuperscript{88}

This modification provides that, with respect to deposit accounts, the third element of attachment is satisfied if “the secured party has control under Section 9-104 . . . pursuant to the debtor's security agreement.”\textsuperscript{89} Control will be examined later,\textsuperscript{90} but it is interesting to note that the incorporated definition—security agreement—does not require a writing. A security agreement is simply “an agreement that creates or provides for a security interest.”\textsuperscript{91} The definition of “agreement” in Article 1—applicable to Revised Article 9—simply refers to “the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance.”\textsuperscript{92} Thus, attachment (at least with respect to deposit accounts) has no signed writing requirement.\textsuperscript{93} As a consequence, a security interest in favor of a bank in a deposit account can arise by implication as well as by express oral agreement—\textsuperscript{94} a fact that third party creditors will have to face each time they seek to garnish a deposit account.

2. Proceeds—Revised Sections 9-302(f) and 9-315(a)(2)

As before, attachment of a security interest in proceeds of collateral is automatic if the security interest attached in the original collateral.\textsuperscript{95} Revised section 9-302(f), however, states that the

\begin{itemize}
\item 88. See id. § 9-203(b)(3).
\item 89. Id. § 9-203(b)(3)(D). This section also applies to security interests in electronic chattel paper, investment property, and letter-of-credit rights. See id.
\item 90. See infra Part IV.G.
\item 91. R. § 9-102(a)(73).
\item 92. See id. § 9-102(c).
\item 93. U.C.C. § 1-201(3).
\item 94. Revised Article 9 also does not require a specific description of the deposit account by identifying number. Deposit accounts are subject to the general rule of Revised section 9-108, which states that a sufficient description need only “reasonably identify[ing] what is described.” See R. § 9-108(a). Thus, a generic description of “all deposit accounts” should cover all accounts, especially since Revised Article 9 validates the parties’ choice of defined types of collateral. See id. § 9-108(b)(3). Indeed, the comments indicate that, at least in the security agreement, use of the term “deposit account” or something which similarly describes the banking relationship, will be necessary. See id. § 9-109 cmt. 16.
\item 95. This result is recognized in the comments to Revised section 9-104 which describe the consequences of control: “[C]ontrol . . . pursuant to the debtor’s agreement’ may substitute for an authenticated security agreement as an element of attachment.” Id. § 9-104 cmt. 2. Since control can exist simply by the bank’s maintenance of the deposit account, see id. § 9-104(a)(1), there is no necessity (as opposed to prudence) of a writing for a security interest to attach.
\item 96. See id. § 9-203(f) (“The attachment of a security interest in collateral gives the secured party the rights to proceeds provided by Section 9-315 . . . ”).
\end{itemize}
attachment is only to the extent provided by Revised section 9-315. Revised section 9-315 carries over the requirement that “a security interest attaches to any identifiable proceeds of collateral.” As indicated above, whether a deposit account contains “identifiable” proceeds will be a question answered by “method[s] of tracing, including application of equitable principles, that is permitted under law other than this article with respect to commingled property of the type involved.”

C. Perfection

Perfection is one of the essential goals of a secured party. Under current law, a perfected security interest is senior to a judicial lien creditor and, to the extent a bankruptcy trustee has a lien creditor’s status, is immune in bankruptcy. Broadly speaking, whereas attachment makes a security interest good as against the debtor, perfection makes it good as against the world. Much of the debate regarding inclusion of deposit accounts in Revised Article 9 centered on the method of perfection that would be chosen. California and other states which had nonuniform inclusion of deposit accounts under existing Article 9 relied typically on a combination of automatic perfection (if the secured party was the bank maintaining the deposit account) and nonpublic notice to the bank holding the account (if the secured party was not the bank holding the account).

In the early stages of the Revised Article 9 project, proposals floated which would have made perfection in a deposit account, at least by nondepositary banks, dependent on filing. This proposal lost, and Revised Article 9 essentially directs inquiring creditors not to a public registry but to the bank maintaining the account.

97. See id.
98. Id. § 9-315(a)(2) (emphasis added).
99. See supra Part II.A.3.
100. R. § 9-315(b)(2).
102. See U.C.C. § 9-301(4).
104. See PEB STUDY, supra note 16, at 70.
1. Original Collateral—Control and Revised Sections 9-312(b) and 9-314

With respect to deposit accounts as original collateral, Revised Article 9 is clear: "[A] security interest in a deposit account may be perfected only by control under Section 9-314." Revised section 9-314, in turn, simply contains a reference to the definition of control for deposit accounts.

What is "control"? It is a concept borrowed from Article 8 on investment securities. Article 8 developed the concept to accommodate the ways in which securities are purchased and encumbered without the need for direct possession. Under Article 8, "[t]he key to the control concept is that the purchaser has the present ability to have the securities sold or transferred without further action by the transferor." Since 1994, this concept of control has been part of Article 9 with respect to investment property, which includes securities and security entitlements.

Revised Article 9 retains the control concept for investment property and adapts it and applies it to deposit accounts as well. In this respect, Revised Article 9 treats the deposit account less like a specialized receivable and more like a security, less like an intangible asset without a fixed locus and more like a tangible asset located at the bank holding the deposit. With the concept of control in place, Revised Article 9 then lists three methods by which a secured party may obtain the necessary control.

a. Automatic Control by Maintaining Deposit Account—Revised Section 9-104(a)(1)

The first and easiest method of control is by simply maintaining the deposit account. Revised Article 9 states that "[a] secured party

105. R. § 9-312(b)(1) (emphasis added); see id. § 9-104 cmt. 2 ("[W]hen a deposit account is taken as original collateral, the only method of perfection is obtaining control under this section.").
106. See id. § 9-314(a).
107. See id. § 9-104 cmts. 1, 3.
108. See U.C.C. § 8-106 cmt. 7 ("A principal purpose of the 'control' concept is to eliminate the uncertainty and confusion that results from attempting to apply common law possession concepts to modern securities holding practices.").
109. Id.
110. See U.C.C. § 9-115(1)(f).
111. See R. § 9-106.
112. See id. § 9-104(a).
113. See id.
has control of a deposit account if: (1) the secured party is the bank with which the deposit account is maintained.\textsuperscript{114} Since attachment can occur without a written agreement, this essentially means that creditors must always assume that a bank has a security interest in all of its customers' commercial deposit accounts. Revised Article 9 is explicit on this point: "[a]ll actual and potential creditors of the debtor are always on notice that the bank with which the debtor's deposit account is maintained may assert a claim against the deposit account."\textsuperscript{115}

\textit{b. Control by Agreement—Revised Section 9-104(a)(2)}

A second method to obtain control is of interest to non-bank secured parties such as asset-based lenders. Under this method, a secured party obtains control if "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 account without further consent by the debtor."\textsuperscript{116}

There are several elements of this type of control. First, the use of the verb "agreed" presupposes an agreement, which should incorporate the Article 1 definition of a "bargain in fact."\textsuperscript{117} Next, that agreement must be contained in an "authenticated record."\textsuperscript{118}

The main component of this form of control, however, is the last element. The bank maintaining the deposit account must agree to "comply with instructions originated by the secured party directing disposition of the funds in the account without further consent by the debtor."\textsuperscript{119} The key here is the lack of any future consent by the

\begin{itemize}
  \item \textsuperscript{114} Id. § 9-104(a)(1).
  \item \textsuperscript{115} Id. § 9-104 cmt. 3.
  \item \textsuperscript{116} Id. § 9-104(a)(2). A proposed form of control agreement, originally drafted by and reprinted with the consent of Edwin Smith, Esq., of Bingham Dana, appears as an Appendix to this article.
  \item \textsuperscript{117} See U.C.C. § 1-201(3).
  \item \textsuperscript{118} See R. § 9-104(a)(2). The cognate term under existing Article 9 would be a "signed writing." See id. § 9-102 cmts. 9a, 9b. A "record" is defined as "information that is inscribed on a tangible medium or which is stored in an electronic or other medium and is retrievable in perceivable form." Id. § 9-102(a)(69). Revised Article 9 intends that this definition be media-neutral; that is, it is pliable enough to apply to both traditional paper transactions and modern electronic ones. See id. § 9-102 cmt. 9a. "Authenticate" takes the place of and expands on the concept of "signing." Thus to "authenticate" a writing is "to sign" or "to execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in part, with the present intent of the authenticating person to identify the person and adopt or accept a record." Id. § 9-102(a)(7). This definition, thus, picks up not only traditional manual signing with a pen and paper, but also any process by which the party acting identifies himself and accepts the writing as his. Thus, many digital signature regimes will be brought into Revised Article 9.
  \item \textsuperscript{119} Id. § 9-104(a)(2).
\end{itemize}
debtor; under Revised Article 9, the inability of the debtor to countermand the secured party's actions gives the secured party the control necessary to put others on notice of its interest. Thus, the secured party will have control of any disposition, even if such a disposition is not commercially reasonable or if other documentation between the debtor and the secured party does not give the secured party the right to take the proceeds. In short, control is linked to the power, as opposed to the right, to direct disposition.

As a consequence, a bank need not listen to a debtor who correctly asserts that an order from the secured party to dispose of funds on deposit is not authorized by other agreements. In the securities area, some have drafted their control agreements to obtain in advance the debtor's consent to any such action so as to allay any concerns by those holding the securities.

An alternative to such a situation is to place conditions on the secured party's future directive, such as requiring a certificate that the debtor is in default. The comments indicate that this type of condition will not vitiate control, so long as the debtor has no ability to rescind the secured party's authority.

c. Control by Becoming Bank's Customer—Revised Section 9-104(a)(3)

The final method for obtaining control is for the "secured party [to] become[] the bank's customer with respect to the deposit account." As Revised section 9-102(b) indicates, the use of "customer" in this context means the same as it does in Article 4: "a person having an account with a bank or for whom a bank has agreed to collect items, including a bank that maintains an account at another

120. Cf. id. § 9-104 cmt. 3 ("Of course, if the condition [to the secured party's giving any order regarding disposition] is the debtor's further consent, the statute explicitly provides that the agreement would not confer control.").

121. As a consequence, a secured party might still be liable for the consequences of a commercially unreasonable disposition or might be enjoined in appropriate cases. See id. § 9-625(a).

122. See, e.g., Edwin E. Smith, The Emerged and Emerging New Uniform Commercial Code: Sample Form of Revised UCC Articles 8 and 9 Securities Account "Control Agreement", SC36 A.L.I.-A.B.A. 63 (1997); see also R. § 8-106 cmt. 7 (suggesting that any similar control agreement provide that the conditions are effective only between secured party and debtor and not as between secured party and securities intermediary).

123. See R. § 9-104 cmt. 3 ("An agreement to comply with the secured party's instructions suffices for 'control' of a deposit account under this section even if the bank's agreement is subject to specified conditions, e.g., that the secured party's instructions are accompanied by a certification that the debtor is in default.").

124. Id. § 9-104(a)(3).
Thus, the secured party becomes a person in privity with the bank maintaining the account and, as the comments make clear, "would enjoy the right ... to withdraw funds from ... the deposit account."\textsuperscript{126} By use of the definite article "the," the text would seem to indicate that the secured party could be the only customer with respect to the deposit account, but this is not crystal clear.\textsuperscript{127} One way in which the secured party could achieve customer status would be to have the bank maintaining the account place the account in the secured party's name.\textsuperscript{128} This may create problems, however, in terms of the debtor's access to the account, unless the debtor is added as an additional signatory to the account (with likely limits on the amount of checks authorized under its signature).\textsuperscript{129} This method of control, which has significant benefits in priority contests,\textsuperscript{130} will likely not be used for operating accounts, but rather for blocked accounts containing funds the debtor does not intend to use in its everyday business affairs.

2. Deposit Accounts as Proceeds of Other Collateral—Revised Section 9-315

Revised Article 9 carries forward the current rule that perfection in the original collateral suffices for perfection in the proceeds,\textsuperscript{131} at least for twenty days.\textsuperscript{132} On the twenty-first day after the security interest attaches in the proceeds, the security interest becomes unperfected unless, among other things, the proceeds are indentifiable cash proceeds.\textsuperscript{133} Since deposit accounts are "cash proceeds,"\textsuperscript{134} the primary issue with proceeds will be, as previously

\textsuperscript{125} U.C.C. § 4-104(a)(5).
\textsuperscript{126} R. § 9-104 cmt. 3.
\textsuperscript{127} Revised section 9-104(b) seems to indicate that it need not be. That section states that "[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." \textit{Id.} § 9-104(b). The comments emphasize this point. \textit{See id.} § 9-104 cmt. 3 ("[S]ubsection (b) makes clear that the debtor's ability to reach the funds is not inconsistent with 'control.'").
\textsuperscript{128} \textit{See id.} § 9-327 cmt. 4.
\textsuperscript{129} Setting up the account in this manner also raises questions as to how the bank maintaining the account will report any interest accrued and as to the manner as to which the secured party will credit any deposits by the debtor into the account. \textit{See infra} Part IV.G.
\textsuperscript{130} \textit{See infra} Part II.D.1.
\textsuperscript{131} \textit{See} R. § 9-315(c) ("A security interest in proceeds is a perfected security interest if the security interest in the original collateral was perfected.").
\textsuperscript{132} \textit{See id.} § 9-315(e).
\textsuperscript{133} \textit{See id.} § 9-315(d)(2).
\textsuperscript{134} \textit{See id.} § 9-102(a)(9) ("'Cash proceeds' means proceeds that are money, checks, deposit
indicated, one of identifying, through appropriate means of tracing, the portion of the deposit account allocable to the secured party's proceeds claim.

D. Priority—Revised Section 9-327

The goal of attachment and perfection is priority over creditors, purchasers, and the bankruptcy trustee. If the creditor obtains first priority, it also obtains the ability to control the liquidation process from and after default.

Under existing Article 9, priority over nonconsensual liens, purchasers, and the bankruptcy trustee is established by prior perfection, regardless of whether perfection occurs a year or a nanosecond before the nonconsensual creditor obtains its lien. As to other creditors claiming an Article 9 security interest, priority is established by a first-in-time system; the creditor who first perfects or files its financing statement has priority over other consensual creditors as to the collateral and its proceeds.

Revised Article 9 substantially preserves the priorities in Current Article 9 with respect to priority contests between secured parties with proceeds only. The rules change significantly, however, when one of the priority claimants asserts that its security interest in the deposit account was taken as original collateral; that is, when it is specified and properly described in the security agreement between the secured party and the debtor.

1. Security Interest in Deposit Account That Is Claimed Only as Original Collateral: Creditor with Control Wins Regardless of Timing—Revised Section 9-327(1)

In most cases of priority conflict involving claims to deposit accounts as original collateral, only one secured party will be in control of the account within the meaning of Revised section 9-104. Not surprisingly, the secured party in control will prevail. Under accounts, or the like.

135. See supra Part II.A.3 on the importance of tracing in obtaining identifiable cash proceeds.
136. See U.C.C. § 9-301(b); see also id. § 9-301(1)(b).
137. See id. §§ 9-312(5) (as to original collateral), 9-312(6) (as to proceeds).
138. These cases could arise if a secured party who has a proceeds claim is unable to trace and identify proceeds and, thus, would not have a proceeds claim, but whose security agreement includes a security interest in deposit accounts.
Revised Article 9, this is explicit by statute,\textsuperscript{139} although the same result would be obtained under the general principle that a perfected security interest—the one held by the secured party in control—has priority over an unperfected security interest—the one held by the secured party who is not in control.\textsuperscript{140} This result is obtained regardless of when the various security interests attached. Put another way, the rule of priority for deposit accounts is not based on temporal priority, but rather is based upon the ability to exercise dominion.

What if more than one secured party has control? This could occur if, for example, a debtor in a workout situation granted two groups of creditors security interests in its deposit accounts, with one group agreeing to be junior to the other. The parties may of course agree to subordinate whatever interest they have to the allocation they have agreed upon themselves.\textsuperscript{141} If there is no agreement, priority will rank "according to priority in time of obtaining control."\textsuperscript{142}

The exception is, of course, with respect to the bank maintaining the deposit account. Unless there is a subordination agreement with that bank, it will prevail automatically over all other security interests in the deposit account.\textsuperscript{143} The only other way a secured party may prevail over the depository bank is by obtaining control through becoming the bank's customer.\textsuperscript{144} In that event, the secured party defeats the bank's security interest.\textsuperscript{145}

2. Security Interests in Deposit Accounts Which Are Each Claimed as Proceeds Only

If no party has taken a security interest in the deposit account as original collateral, then the rules regarding priority change, but are

\textsuperscript{139} See R. § 9-327(1).
\textsuperscript{140} The general principle is stated in Revised section 9-322(a)(2). With deposit accounts as collateral, however, perfection as to original collateral can only be by "control." See id. § 9-312(b)(1); see also supra Part II.C.1. As a consequence, a secured party who does not have control is also unperfected, at least to the extent the claim is one to the deposit account as original collateral.
\textsuperscript{141} See R. § 9-339. If the secured party maintaining the deposit account is also an indenture trustee on an outstanding issue of securities subject to the Trust Indenture Act, the sharing might be mandatory. See Trust Indenture Act § 311(a), 15 U.S.C. § 77kkk(a) (1994).
\textsuperscript{142} R. § 9-327(2).
\textsuperscript{143} See id. § 9-327(3). By becoming the bank's customer, the secured party also becomes senior to any setoff or recoupment right the depository bank may have against the debtor. See id. § 9-340(c).
\textsuperscript{144} See id. § 9-104(a)(3).
\textsuperscript{145} See id. § 9-327(4).
basically the same as under Current Article 9. First, of course, the secured creditor must have some claim to the account. Revised Article 9 allocates claims to proceeds in deposit accounts according to non-Article 9 tracing rules. That is, if the secured party is able to “identify[y] the proceeds by a method of tracing, including application of equitable principles, that is permitted under law other than this article,” then its claim to proceeds attaches, and its right to that portion of the deposit account so identified is superior to the debtor’s.

As to competing security interests which also can trace their proceeds into the deposit account, Revised Article 9 continues the current general rules. So long as the proceeds are deemed part of the deposit account, they will be perfected. With a perfected security interest in at least part of the deposit account, the secured party will defeat any involuntary lien creditor (or garnishor) as to that part.

As between two competing consensual security interests, Revised Article 9 continues the “first-in-time” rule; the secured creditor who filed or perfected first with respect to its original collateral has the same priority as to the proceeds and defeats the secured creditor who filed later. This is the case even if the later-filing creditor’s collateral description better matches the form of the collateral at the time of the dispute. As a consequence, Revised Article 9 allocates priority between two secured creditors in these cases by referring to the first date upon which one of the secured parties was perfected or filed its financing statement as to its original collateral. As an example, as between an inventory financier and a factor financing accounts arising from such inventory, the secured party who filed its financing statement (as to inventory or accounts) will have priority over proceeds existing in the deposit account.

146. Revised section 9-315(b)(2) provides:

Proceeds [that are not goods] that are commingled with other property are identifiable proceeds . . . to the extent that the secured party identifies the proceeds by a method of tracing, including application of equitable principles, that is permitted under law other than this article with respect to commingled property of the type involved.

147. R. § 9-315(b)(2).

148. See id. § 9-315(d)(2).

149. See id. § 9-317(a)(2).

150. See id. § 9-322(a)(1). Under Revised Article 9, as under Current Article 9, the perfection date for proceeds is the date of filing or other perfection for the original collateral. See id. § 9-322(b)(1).
3. When Security Interest in Deposit Account Is Claimed Both as Original Collateral and as Proceeds: "Control" Is King—Revised Sections 9-104, 9-327, and 9-322(f)

If a secured party claims the deposit account as proceeds and another secured party claims the deposit account as original collateral, the result is simple and potentially harsh: the person in control of the deposit account wins. This follows from the rules applicable to deposit accounts: "A security interest held by a secured party having control of the deposit account under Section 9-104 has priority over a conflicting security interest held by a secured party that does not have control." Control is, thus, the sole determinant.

E. Proceeds of Deposit Accounts

In the normal course of commerce, funds will flow into and out of deposit accounts. And since deposit accounts are typically media through which financial transactions are carried out, the question of rights to proceeds from a deposit account will be critical.

As an initial matter, recall that a security interest continues in collateral unless a provision of Article 9 terminates it or unless the secured party authorizes the termination. Recall also that proceeds are defined generically as anything received on the exchange or disposition of collateral. Thus, in any transaction, there is a presumption that the security interest "sticks" to the collateral regardless of the change of ownership and also adheres to whatever the transferor received in exchange for the transfer.

Revised Article 9 has two very different treatments of these interests. For purposes of reference, I use the term "continuation proceeds" to refer to the continued interest in funds or cash paid by the depositary bank pursuant to its deposit account agreement. In contrast, I use the term "exchanged proceeds" to refer to what the transferor receives for causing the bank to part with the funds pursuant to the deposit account agreement.

151. Id. § 9-327(1).
152. See id. § 9-315(a)(1).
153. See id. § 9-102(a)(64).
154. Technically, these are not proceeds but a portion of the original collateral upon which a security interest is still attached. Given the intangible nature of the collateral and the fact that it is "original" only by convention, I have tried to keep parallel terms.
1. Continuation "Proceeds": Cash or Funds Paid Out—Revised Section 9-322

Under Current Article 9, one almost has to take on faith that funds paid out of a deposit account in the ordinary course—as by check or other order—are free of the secured party’s proceeds claim. Nothing in the statute expressly dictates this result, and the most the current statute musters is a comment that “[w]here cash proceeds are covered into the debtor’s checking account and paid out in the operation of the debtor’s business, recipients of the funds of course take free of any claim which the secured party may have in them as proceeds.” The comment then restricts this claim to ordinary course transactions, leaving all unusual transactions to the realm of fraudulent transfer law.

Particularly with the addition of deposit accounts as original collateral in business transactions, more was needed. Revised Article 9’s response is in section 9-322. It provides that a person takes cash (such as might be paid out over the counter) or funds (such as might be paid through the check clearing system) free of the security interest in the deposit account “unless the transferee acts in collusion with the debtor in violating the rights of the secured party.”

This places a high hurdle on the secured party wishing to pursue a cash or funds recipient, which is intentional. The comments indicate that this standard was borrowed from Article 8 and it adopts “the most protective (i.e., least stringent) of the various standards now found in the UCC.” Reading the statute in this light, it appears that not only is collusion between the debtor and the recipient to be proved, but the secured party will also need to prove that the collusion was aimed at violating the secured party’s rights. This derives from the phrase “collusion with the debtor in violating the rights of the secured party,” since this links collusion with the violation of the secured party’s rights. Thus, a swindle or check kite aimed at bilking others might be a collusive transaction, but unless

156. See U.C.C. § 9-306 cmt. 2c.
158. R. § 9-332(a)-(b) (parallel language used for cash and for funds). This standard does not apply to a transfer of a deposit account or to the creation of a security interest. See id. § 9-332 cmt. 2.
159. Id. § 9-332 cmt. 4.
the secured party was in the zone of the scheme's victims, Revised Article 9 will not serve as a predicate for the return of funds.

2. Exchanged Proceeds: What Is Received upon Transfer of Funds from Deposit Accounts

One can understand the reluctance to allow secured parties to pursue cash and funds transferred by banks as support for the funds clearing system. No such interest, however, supports limiting pursuit of what is received in exchange for the funds, and Revised Article 9 allows secured parties to pursue such collateral.

The rules, however, are quite complicated. The source of this complication is that secured parties may claim priority under two different systems: the nontemporal priority system, upon which priority is based upon control, whenever acquired; and the temporal system, upon which priority is based on first in time of perfection or filing. These two systems potentially clash when a debtor acquires collateral with funds traceable from a deposit account and the collateral acquired also fits within the security interest of a competing secured party.

Revised Article 9 mediates these differences based on the form of the disputed collateral. Essentially, those claiming under nontemporal methods prevail if the disputed collateral is cash proceeds or similar collateral; and those claiming under temporal methods of priority prevail in cases of noncash proceeds. There are subtle differences, however, involved, requiring a detailed examination of these provisions.

a. Temporal Priority Claimants vs. Nontemporal Priority Claimants—Revised Sections 9-322(d), (e), and (f)

Revised section 9-322(c) begins the analysis. It states a "special priority rule" which provides that once a secured party has priority through control,160 it has the same priority as to certain types of proceeds.161 To retain its priority, the secured party's security interest

160. Technically, the statute states that "a security interest in collateral which qualifies for priority over a conflicting security interest under Section 9-327 ... also has priority over a conflicting security interest in: ... proceeds," subject to certain conditions. See id. § 9-322(c). Section 9-327, the embedded reference, provides priority rules for perfected security interests in deposit accounts and essentially ranks priority in terms of actual control at the time of the dispute, rather than by the time the secured party obtained control. See id. § 9-327.

161. See id. § 9-322(c). Technically, the statute applies any time a secured party has nonfiling priority under section 9-327 (deposit accounts), 9-328 (investment property), 9-329 (letter-of-credit rights), 9-330 (chattel paper), or 9-331 (certain negotiable instruments or securities
initially must be perfected, 162 and the collateral claimed as proceeds must be "cash proceeds or of the same type as the collateral." 163 Further, if the disputed collateral is proceeds of proceeds, all the intervening proceeds leading to the disputed collateral must have been "cash proceeds, proceeds of the same type as the collateral, or an account relating to the collateral." 164

(1) When the Disputed Collateral Is Cash Proceeds Without Any Intervening Noncash Proceeds

Some examples may make this clearer. Assume $D$ has granted a security interest in deposit accounts to Bank $A$ to secure all obligations the debtor owes to $A$. $D$ maintains a deposit account at $A$ and owes significant sums to $A$. One day, $D$ uses funds in that deposit account to purchase a nonnegotiable certificate of deposit from Bank $B$. If that certificate of deposit is proceeds of the original deposit account, then the secured party is perfected in it since it is identifiable cash proceeds. 165

Assume further that another secured party, SP-2, with a perfected security interest in, say, inventory only, could have traced and laid claim to the entire deposit account at Bank $A$ as sales proceeds of its inventory, and can similarly trace and lay claim to the Bank $B$ certificate of deposit.

Who has a superior claim to the certificate of deposit? The answer is Bank $A$, without the need to know when Bank $A$'s security interest in the deposit account was created. Bank $A$ had control under section 9-327 of the deposit account and, thus, had priority before the purchase. Section 9-322(c) continues that priority as long as Bank $A$'s interest continues to be perfected (the tracing and identifiability of the funds ensure that for both parties) and as long as the proceeds are

entitlements under Article 8).

162. *See id. § 9-322(c)(2)(A).*

163. *Id. § 9-322(c)(2)(B).*

164. *Id. § 9-322(c)(2)(C).*

165. If the certificate of deposit were purchased with funds traceable to an encumbered deposit account, the certificate of deposit should be "proceeds"; the critical question is whether it is "cash proceeds." *See id. § 9-102(a)(9).* Under existing law, at least one court has held that certificates of deposit are not cash proceeds, relying on "common sense" interpretations of revisions covering certificates of deposit. *See Citicorp (USA), Inc. v. Davidson Lumber Co., 718 F.2d 1030 (11th Cir. 1983).* Under Revised Article 9, if the certificate of deposit is not itself a deposit account (because it is an instrument, for example), the issue of whether it is "cash proceeds" will depend on whether the certificate of deposit is "functionally equivalent" to a deposit account. *See R. § 9-102 cmt 13e.*
"cash proceeds" such as the certificate of deposit.\textsuperscript{166}

The result is not changed so long as the "type" conditions specified in section 9-322(c)(2)(C) are met; that is, so long as "all intervening proceeds are cash proceeds, proceeds of the same type as the collateral, or an account relating to the collateral."\textsuperscript{167} Thus, if the debtor transferred the certificate of deposit to Carl and took a check in exchange, the check would be proceeds of proceeds (sometimes called second-generation proceeds), and Bank A's priority would continue into Carl's check.\textsuperscript{168} The same result would occur if Carl merely promised to pay for the certificate of deposit and then later settled his debt with a check. His intervening promise would be an account\textsuperscript{169} related to the collateral, one of the favored types of collateral for Bank A to continue its priority. Thus Bank A will have priority over SP-2.

(2) When the Disputed Collateral Is Noncash Proceeds

If, however, $D$ uses funds from the deposit account to acquire new inventory, the result changes. The reason for this change is that it is no longer the case that "all intervening proceeds are cash proceeds, proceeds of the same type as the collateral, or an account relating to the collateral" as required by the special priority rule of Revised section 9-322(c)(2).\textsuperscript{170} Revised section 9-322(c) thus does not apply.

If section 9-322(c) does not apply, who has priority? In this case, SP-2 will likely have priority as to the inventory. This result comes from Revised section 9-322(d), which applies so long as the disputed collateral is not "not cash proceeds, chattel paper, negotiable documents, instruments, investment property, or letter-of-credit

\textsuperscript{166} Under Revised section 9-102(a)(9), cash proceeds include proceeds that are "money, checks, deposit accounts, or the like."

This analysis of course ignores the rights, if any, of Bank B since, in the absence of subordination or a control agreement, any security interest that Bank B holds in the certificate of deposit would be senior to both Bank A and the inventory lender under section 9-327 (if a consensual security interest exists) or under section 9-340 (common law setoff).

\textsuperscript{167} R. § 9-322(c)(2)(C).

\textsuperscript{168} Its security interest in the certificate of deposit would also continue, and Bank A would continue to enjoy priority with respect to it as well.

\textsuperscript{169} An account no longer needs to be related to the provision or promised provision of goods and services. Under Revised section 9-102(a)(2), it is the broad-based term for any "right to payment of a monetary obligation, whether or not earned by performance, (i) for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, (ii) for services rendered or to be rendered." The substitution of "property" for "goods" (the locution used in Current Article 9 section 9-106) significantly expands the scope of the term "account."

\textsuperscript{170} See R. § 9-322(c)(2)(C).
Subsection (d) provides that if a security interest in deposit accounts is perfected initially by a method other than filing, "conflicting perfected security interests in proceeds of the collateral rank according to priority in time of filing." 172

Under this filing standard, who has priority? First note that both A and SP-2 have perfected security interests in the inventory. SP-2’s security agreement and financing statement both list inventory, so its position is simple to analyze. Bank A, on the other hand, perfected its security interest in the deposit account by control—a method “other than filing.” That does not destroy its interest in the inventory, however; as long as it can trace funds from the account into the inventory, it will have a perfected security interest in the inventory, at least for twenty days. 173 Moreover, so long as it files within this twenty-day period, its perfection will continue beyond that period. 174

Even though perfected, Bank A will likely lose to SP-2 so long as SP-2’s financing statement predates any financing statement filed by Bank A. Under subsection (d), conflicting security interests “rank according to priority in time of filing.” If the inventory lender filed before the debtor’s acquisition of the inventory—a likely occurrence 175—then its security interest will prevail over Bank A. 176

(3) When the Disputed Collateral Is Cash Proceeds, but There Are Intervening Noncash Proceeds

What happens if, using the above example in (2), the inventory is sold and the proceeds again take the form of cash proceeds? Continue the example above, but now assume that the debtor sells the inventory for cash and places the funds not in A, but in a new deposit account at Bank B. 177 In this case, subsection (c) will not supply the rule of priority since there are intervening noncash proceeds; here, it

171. Id. § 9-322(e).
172. Id. § 9-322(d).
173. See id. § 9-315(d). The statute says that the interest becomes unperfected on the 21st day after attachment, thereby giving 20 days of protection.
174. See id. § 9-315(d)(1).
175. If Bank A had a financing statement on file which predates the inventory lender’s, then the inventory lender presumably could have taken steps to assess the risk such a filing presented either by obtaining a control or subordination agreement from A. Since it did not, it is not unfair to allocate the loss to it should the deposit account prove insufficient to satisfy all secured claims against it.
176. As noted in the comments, “[t]his corresponds with the likely expectations of the parties.” R. § 9-322 cmt. 9, example 12.
177. To reduce complexity, assume that B is unrelated to any other party and that it does not claim any setoff rights or any security interest in the new deposit account.
is the inventory. When the inventory is sold, however, and the proceeds placed in another deposit account, the special rule of Revised section 9-322(d) ceases to apply, since subsection (e) makes clear that subsection (d) applies "only if the proceeds of the collateral are not cash proceeds."\textsuperscript{178} Since the inventory blocks the trail of cash proceeds, Revised section 9-322(d) is no longer available.

In this case, then, since no special priority rule is available, the general rules of Revised section 9-322(a) and (b) will determine priority, and they provide that priority tracks "according to . . . time of filing or perfection."\textsuperscript{179} It thus becomes imperative in this situation to know when Bank A first became perfected; that is, when it first obtained control over the original deposit account.\textsuperscript{180} Since both parties appear to be perfected continuously at all relevant times, a court will then compare that date of perfection to the date upon which the inventory lender filed against its collateral to determine ultimate priority.\textsuperscript{181}

\textit{b. The Trump Position—When the Proceeds Wind Up Back in the Original Deposit Account}

The examples above assume that the disputed collateral is no longer in the same deposit account from which the proceeds claim arose. What if that assumption is relaxed and the funds wind up back at Bank A? Bank A, the bank with control over the account, prevails, again without regard to time of filing. The special priority rules of subsections (c) and (d) of section 9-322 each contain an exception for conditions specified in subsection (f). Subsection (f), in turn, states that the special priority rules are subject to "the other provisions of this part."\textsuperscript{182} As comment 8 makes clear, "[o]ne of those ‘other provisions’ is Section 9-327, which affords priority to a security interest perfected by control."\textsuperscript{183}

As a consequence, regardless of claims to proceeds if the debtor deposits proceeds back into the original deposit account, the rules of

\textsuperscript{178} R. § 9-322(e) (emphasis added).

\textsuperscript{179} Id. § 9-322(a)(1).

\textsuperscript{180} This assumes that the date of creation of the account will control for all subsequent deposits, and the initial agreement between the bank and depositor contains a clause granting a security interest in the account in favor of the depository bank. At least in bankruptcy, the assumption regarding the date of creation may not be a realistic assumption. \textit{See infra} Part IV.F.

\textsuperscript{181} See R. § 9-322 cmt. 9, example 13.

\textsuperscript{182} Id. § 9-322(f)(1).

\textsuperscript{183} Id. § 9-322 cmt. 8.
Revised section 9-327 come back into play, and whoever has control of that account has priority over all other claimants.

c. A Short Walk Through the Brambles—An Attempt to Explain How Revised Section 9-322 Works

The following examples attempt to summarize these rules. Assume that Debtor $D$ owes a significant sum to Bank $A$, where it keeps its operating bank account. $D$ wants to finance a new line of inventory and convinces Vendor $B$ to sell it inventory on a 100% purchase-money secured basis. $B$ checks the filing record and finds that no financing statement has been filed against $D$. $B$ then files its financing statement against $D$ on Day 1. It then ships goods to $D$ on Day 2. On Day 3, $D$ sells the goods on thirty-day terms to Buyer $C$. On Day 33, $C$ sends a check to $D$ in full satisfaction of its debt. On Day 34, $D$ receives the check, endorses it, and deposits it in its account at Bank $A$.

Examine the results at each stage of the transaction. As of Day 2, $B$ has a perfected security interest in the inventory, and Bank $A$ has no interest in it whatsoever since $D$ did not use any funds from the deposit account to acquire the inventory. On Days 3 through 33, the same result obtains; $B$ has a perfected security interest in the account generated on sale, and $A$ still has no interest in the account. When the check is given to $D$, again the same result; as identifiable cash proceeds, $B$'s interest continues as a perfected interest in identifiable proceeds (the check). When the check is deposited, however, the collected proceeds become subject to Bank $A$'s security interest, and under Revised section 9-327, Bank $A$ has priority.\footnote{The purchase money priority rules in Revised section 9-324 are expressly subject to security interests perfected by control under Revised section 9-327. See id. § 9-324(a)-(b).}

Now change the facts. Instead of Vendor $B$, assume that $D$ goes to Bank $B$ and arranges to borrow funds to finance its inventory. On Day 1, $B$ files its financing statement against the inventory after checking the filing record and finding no financing statements on file against $D$. On Day 2, $B$ gives $D$ a check for its loan, which $D$ deposits in its deposit account at Bank $A$. $D$ then writes a check against that account to purchase the inventory which is delivered on Day 3.\footnote{Would the result change if $D$ deposits the check in another bank? Yes. Since Bank $A$ had no claim to the original inventory, it would have no claim to any proceeds, either.} On the same day, $D$ sells the goods to Buyer $C$ on thirty-day terms. On

184. The purchase money priority rules in Revised section 9-324 are expressly subject to security interests perfected by control under Revised section 9-327. See id. § 9-324(a)-(b).

185. Assume, for purposes of this modification of the hypothetical, that the lender finances 100% of the acquisition price.
Day 33, C sends D a check in full satisfaction of its debt. D receives the check on Day 34, endorses it, and deposits it in its account at Bank A.

Now examine the results at each stage of this modified transaction. Once the loan funds are part of the deposit account at Bank A, Bank A has priority since it has control.\textsuperscript{186} When D writes the check to purchase the inventory, the result does not change, since the check is not considered proceeds of the deposit account.\textsuperscript{187} Once the inventory is delivered on Day 3, both A and B have a perfected security interest in the goods; A’s claim is as proceeds from the deposit account, and B’s is a claim as to the inventory as original collateral. At this point, B’s claim is superior under the rule stated in Revised section 9-322(d), which allocates priority to the first to file, which in this case is B.\textsuperscript{188}

When the inventory turns into an account on Day 3, both A and B continue to have perfected security interests in the account. Since an “account” is not “cash proceeds,” we again have to look to subsection (d) of Revised section 9-322. Under this rule, the first to file has priority, which in this case would again be Bank B.

What then happens on Day 33 when C sends its check? The check is cash proceeds of the account, but is it also cash proceeds of all prior forms of the collateral as well? This matters if Bank A does not file within twenty days after the sale. Without a filing, Bank A will become unperfected as to the account as of Day 24 (twenty-one days after attachment, which occurred on Day 3). Does it become re-perfected upon transmutation of the account into identifiable cash proceeds? The answer is yes at one level—it surely has an interest in the check senior to that of a lien creditor or anyone having the status of a lien creditor.\textsuperscript{189} The next question is priority as between the two

\textsuperscript{186} I assume here that B also takes a security interest in its loan proceeds check, a fairly standard loan provision. This interest would then follow as a proceeds interest, albeit a subordinate one, into the deposit account at Bank A. Otherwise, B would have no interest in the deposit account at Bank A.

\textsuperscript{187} See R. § 9-332 cmt. 2, example 1. Although the check may be proceeds in the hands of the recipient, it is not from the perspective of the secured party with a security interest in the account against which the check is drawn. Since that check does not operate independently to assign the funds, see U.C.C. § 3-408, the check itself should not be considered proceeds. When the check is paid, however, the funds or credits used in payment should be considered proceeds since there then is a transfer of funds.

\textsuperscript{188} See R. § 9-322 cmt. 9, example 12.

\textsuperscript{189} This is because it can identify the check as proceeds of its collateral through tracing, and “a security interest attaches to any identifiable proceeds of collateral.” Id. § 9-315(a)(2). This security interest is perfected, and thus senior to a lien creditor, since the check is “cash proceeds,” see id. § 9-102(a)(9), and since tracing allows the secured party to identify it to the
parties; in short, who does Revised section 9-322 favor? The quick answer is that, at this point, the general rules of subsections (a) and (b) apply, and priority goes to the first to file or perfect. The special priority rule of subsection (d) is inapplicable. Thus, the issue is whether A was first to “file or perfect.”

On this point, section 9-322(a)(1) is clear: “Priority dates from the earlier of the time a filing covering the collateral is first made or the security interest or agricultural lien is first perfected, if there is no period thereafter when there is neither filing nor perfection.” Thus, the gap caused by its failure to file dooms Bank A’s priority claim.

B’s victory, however, is short-lived. The instant D deposits the check into its deposit account at A, the priority rules of Revised section 9-327 will apply, giving the nod to A who has control. Note that the result potentially shifts if the check is deposited into a deposit account at another bank. Both A and B will stay perfected at this point, since a deposit account is cash proceeds, and since both (by hypothesis) can trace their interests into that account. Without clearcut control, the general rules of subsections (a) and (b) again apply, leaving the break in priority issue (the gap from Day 25 to Day 33 in the example) to regulate the outcome. Since the break moves up A’s date of “filing or perfection” under section 9-322(a)(1), B wins because its period of continuous perfection is longer.

F. Duties and Privileges of Secured Party

Under Revised Article 9, a secured party with a security interest in a deposit account takes on special duties and, to the extent that it is also the depository bank, acquires special privileges. The duties are based upon those of a secured party in possession of collateral and upon the statute. The privileges come in the form of an explicit retention and recognition of non-Article 9 rights such as setoff.

original collateral, see id. § 9-315(d)(2).
190. See id. § 9-322(a)(1).
191. Id. Subsection (b) clarifies the fact that the same rule carries over for proceeds: “[T]he time of filing or perfection as to a security interest in collateral is also the time of filing or perfection as to a security interest in proceeds.” Id. § 9-322(b)(1).
192. See id. § 9-322 cmt. 8, example 11.
193. See id. § 9-102(a)(9).
194. See id. § 9-322 cmt. 8, example 11.
195. B can influence this result by requiring D to deposit checks into a lock box or other account to which it has control, since by having control it defeats all other secured creditors. See id. § 9-327.
1. Duties—Revised Section 9-208(b)

Revised section 9-208(b) sets forth formal requirements for when a secured party with deposit account collateral is required to relinquish it. Before these requirements apply, however, there are two conditions. First, there must be "no outstanding secured obligation." Second, the "secured party [must not be] not committed to make advances, incur obligations, or otherwise give value." In other words, the lending relationship must be over or its commencement must be solely in the secured party's control.

If those conditions exist, then the debtor can obtain the release of any secured creditor control of the deposit account by sending an "authenticated demand" and then waiting ten days. At the end of that period, if the secured creditor has control under Revised section 9-104(a)(2), the secured party must "send to the bank with which the deposit account is maintained an authenticated statement that releases the bank from any further obligation to comply with instructions originated by the secured party."

If the secured party, however, has control pursuant to Revised section 9-104(a)(3)—that is, if it is the customer on the account—then the secured party must "(A) pay the debtor the balance on deposit in the deposit account; or (B) transfer the balance on deposit into a deposit account in the debtor's name." The comments indicate that this duty is subject to the terms of the collateral itself: "subsection (b)(3) should not require a secured party with control to make an early withdrawal of the funds (assuming that were possible) in order to pay them over to the debtor or put them in an account in the debtor's name."

Revised section 9-208(b) does not mention control under section 9-104(a)(1), such as when the secured party is a bank and the deposit account is maintained with it. The omission is presumably because at least one of the preconditions for release can never be met, that of

196. Id. § 9-208(a).
197. Id.
198. See id. § 9-208(b). The comments indicate that these requirements may be varied under the general rule of section 1-102(3). For example, "a debtor could by contract agree that the secured party may release its control of investment property under subsection (a)(1) more than three days following demand." Id. § 9-208 cmt. 2. To the extent that many lenders will automatically provide for their own standards in deposit agreements or other arrangements, the default rules in Revised section 9-208 may not have significant application.
199. Id. § 9-208(b)(1).
200. Id. § 9-208(b)(2)(A)-(B).
201. Id. § 9-208 cmt. 2.
there being no possibility of the secured party not owing any obligation to the debtor. A bank will always have a contingent obligation to return the funds equal to the account balance, and thus a debtor who has granted a security interest to its bank will never be able to use Revised section 9-208(b).

If a secured party does not honor a proper request under section 9-208(b), then it will incur liability similar to that imposed upon other secured creditors under Revised section 9-625(e) when they fail to release termination statements after proper notice.202

2. Privileges—Revised Sections 9-341 and 9-342

Revised Article 9 gives banks maintaining deposit accounts explicit protection of their position in the banking system. Revised section 9-341 essentially provides that a bank retains all of its rights and remedies with respect to a deposit account notwithstanding its knowledge or notice of a security interest in that account. Thus, if a non-bank secured party notifies a bank that it has taken a security interest in a deposit account or files a financing statement to that effect and sends a copy to the bank, the bank can ignore these notices. Indeed, even if a lender has a legitimate security interest in the deposit account and notifies the bank to turn over the funds to it, the bank need not do so.203

This rule is, however, subject to other law which may govern when and how a bank may pay out funds subject to adverse claims. This law may be found in judicial decisions or it may be statutory as in certain adverse claim statutes.204 As indicated in the comments, the responsibility for taking steps to freeze funds at the depositary bank lies with the non-bank secured party: “A secured party who wishes to deprive the debtor of access to funds on deposit or to appropriate those funds for itself needs to obtain the agreement of the bank, utilize the judicial process, or comply with procedures set forth in other law.”205

In this way, the procedural nature of the relationship between secured creditors claiming proceeds in the form of deposit accounts and banks maintaining those accounts will continue as it is at present.

202. See id. § 9-208 cmt. 3.
203. See id. § 9-341(3).
204. For an explanation of such adverse claim statutes, see 1 CLARK & CLARK, supra note 8, § 3.09[2].
205. R. § 9-341 cmt. 2.
As a consequence, questions regarding whether a bank can continue to honor checks drawn on the account or whether the bank can itself reduce its exposure by setoff will be nonuniform and subject to individual state variance.

This rule is subject to two exceptions: it does not apply if the secured party is the bank's customer and, thus, has control under Revised section 9-104(a)(3), or if the bank has otherwise agreed in an authenticated record. As a consequence, the solution for secured creditors, as indicated by the comments, is to obtain an agreement with the bank as to when the bank will follow the secured party's instructions when the secured party obtains control under section 9-104(a)(2). Any well-drafted control agreement will contain such language. This is small consolation, however, to the non-bank secured party whose collateral is sold and the proceeds transferred to a bank with which the secured party has no subordination or control agreement.

Revised section 9-342 takes this preservation one step further. It explicitly provides that a bank need not enter into any control agreement if it does not want to, even if its customer desires that the bank do so. Moreover, even if it enters into a control agreement, a bank need not "confirm the existence of the [control] agreement to another person unless requested to do so by its customer." This effectively isolates the bank from entering into any agreement it does not wish to enter into and from disclosing whether anyone else may have control.

3. Changes in Bank’s Jurisdiction and Perfection—Revised Section 9-316(f)

Once control is obtained and the security interest perfected, a secured party will want to maintain that perfection. Banks sometimes, usually as part of an acquisition or other combination, change the jurisdiction of their incorporation or change the location of an office maintaining a particular deposit account. Should this occur under

206. *See id.* § 9-340(c).
207. *See id.* § 9-341.
208. *See id.* § 9-341 cmt. 2.
209. An example of such language can be found in the Deposit Account Control Agreement Exemplar located in the Appendix to this article.
210. *See R.* § 9-342 ("This article does not require a bank to enter into an agreement of the kind described in Section 9-104(a)(2), even if its customer so requests or directs.").
211. *Id.*
Revised Article 9 and should the change affect the manner of perfection, the secured party is protected for four months "after a change of the applicable jurisdiction to another jurisdiction."212

This section mirrors the four-month rule for goods generally.213 It is hard to see exactly when it might be applicable, however. If a bank changes jurisdiction from a jurisdiction which has not adopted Revised Article 9 to a jurisdiction which has adopted Revised Article 9, there should be no gap since no public record necessarily publicizes control and since existing Article 9 honors undocumented perfection in "identifiable" cash proceeds in deposit accounts.214 It would seem that the primary realm of applicability might be in changes from a jurisdiction that has adopted Revised Article 9 to a jurisdiction which has not. In that case, the new state will likely treat the deposit account not under Revised section 9-316(f) (since it has not adopted it yet), but under existing Article 9 on the law of general intangibles or under the common law outside of Article 9.

G. Enforcement

When a debtor defaults and the secured party has perfected its interest in a deposit account through control, it has access to very expeditious means of enforcement through Revised section 9-607. In addition, if the secured party is also the bank maintaining the account, it will have setoff rights as well.

1. Foreclosure of Security Interest—Revised Section 9-607

As with all security interests, the secured party realizes its key benefit when the debtor defaults. It is then that the secured party may by-pass the general state law collection scheme and claim priority over competing interests. Revised Article 9 continues this benefit for deposit accounts.

After default, a bank which both maintains and has control over a deposit account "may apply the balance of the deposit account to the obligation secured by the deposit account."215 If the secured party has control by virtue of an agreement with the bank maintaining the account, or because it is the customer, it may upon default "instruct

212. Id. § 9-316(f)(2).
213. See id. § 9-316(a)(2).
the bank to pay the balance of the deposit account to or for the benefit of the secured party." 216 In either case, this "self-help" remedy allows the secured party to reduce the secured obligation dollar for dollar from the balance on account. 218

If a secured party is perfected but does not have control (as will be the case when the secured party is claiming only a proceeds interest), Revised Article 9 maintains the current procedural status of the secured party and does not offer any self-help remedies. 219 The secured party will have to use judicial means, under an adverse claims statute or otherwise, or enlist the consent of the debtor to obtain the funds.

Secured parties perfected by control are not totally unconstrained in exercising this self-help remedy. Revised section 9-607(c) imposes a duty to proceed in a commercially reasonable manner when taking steps to apply the balance of the deposit account against the secured debt. This duty derives from the statute which says that "[a] secured party shall proceed in a commercially reasonable manner if the secured party: (1) undertakes to collect from or enforce an obligation of an account debtor or other person obligated on collateral." 220 In the case of a deposit account, the bank maintaining the account is a "person obligated" upon it; those basic duties derive from the deposit agreement and Article 4. Thus, in the case of a secured party perfected by a control agreement or when it is the customer, it is relatively clear that the secured party must "proceed in a commercially reasonable manner." 221 An example of acting contrary to this duty might be causing the debtor to incur early withdrawal penalties on a interest bearing time deposit by withdrawing the funds a day before maturity when there is no showing of any necessity to act quickly.

The interpretation is less clear if the secured party and the depositary bank are one and the same. In this case, the bank will be perfected under Revised section 9-104(a)(1), and to apply section

216. Id. § 9-607(a)(5).
217. See id. § 9-607 cmt. 7.
218. The use of the permissive "may" does not indicate discretion, in the case in which the bank maintaining the account is not the secured party, to pay the balance. The bank maintaining the account has no discretion in that regard. This obligation arises from the nature of control. See id. § 9-104(a)(2)-(3). Rather, the use of "may" in both paragraphs (4) and (5) confers discretion on the secured party as to how to best proceed.
219. See id. § 9-607 cmt. 7.
220. Id. § 9-607(c)(1) (emphasis added).
221. Id. § 9-607(c).
9-607(c) would literally mean that the words "secured party" and "person obligated" would have the same referent. In other words, one would read section 9-607(c) to say that by applying the balance, the "secured party [the bank] ... undertakes to collect from ... an ... other person obligated on collateral [again, the bank]." In other words, applying a debtor's account balance to the secured obligation is "collecting" from oneself. While this locution is not elegant, the interpretation incorporating it preserves consistency in application and, thereby, does not give a preference to various forms of control which are available only to a particular subset of secured parties.

2. Exercise of Setoff or Recoupment Rights—Revised Section 9-340

The final hurdle a secured party needs to cover is the setoff and recoupment rights of the bank maintaining the deposit account. Under current law, a secured party with a perfected proceeds interest in a deposit account generally defeats a depositary bank's setoff rights. Revised Article 9 changes this dramatically. Under Revised section 9-340, the depositary bank's setoff rights are superior to the secured party's security interest. This provision was intended to resolve an untidy and nonuniform set of priority rules between banks exercising setoff and secured parties (or competing lienholders).

In addition, if the secured party is also the depositary bank, it need not elect between setoff rights and security interests; it may enjoy both simultaneously. The only way, short of subordination, to avoid the priority of the depositary bank is to obtain control by

222. Under current law, setoff rights are excluded from Article 9, see U.C.C. § 9-104(i), an exclusion which Grant Gilmore thought unnecessary and forced upon him by banking interests. As he famously said:

This exclusion [of setoff rights] is an apt example of the absurdities which result when draftsmen attempt to appease critics by putting into a statute something that is not in any sense wicked but is hopelessly irrelevant. Of course a right of set-off is not a security interest and has never been confused with one: the statute might as appropriately exclude fan dancing.

1 GILMORE, supra note 23, § 10.7, at 315-16.

223. See CLARK, supra note 29, ¶ 3.11 ("The courts almost always give priority to the Article 9 claimant, whether the matter is resolved under Article 9 or by fashioning a common law priority rule.").

224. See R. § 9-340(a).

225. See id. § 9-340 cmt. 2.

226. See id. § 9-340(b). Of course, Revised Article 9 does not create setoff or recoupment rights; those are a creature of non-UCC law. See id. § 9-340 cmt. 2. Also, in enforcement of remedies, the depositary bank may wish to be clear about how it is proceeding; proceeding under a security interest brings with it the obligation to proceed in a commercially reasonable way. See id. § 9-607(c). Setoff rights are not similarly regulated by Revised Article 9.
becoming the bank's customer;\textsuperscript{227} not only will this give priority over the depositary bank's security interests in the deposit account,\textsuperscript{228} but also will prevail against any rights of setoff the bank may have against the debtor.\textsuperscript{229}

III. INITIAL RESPONSES TO REVISED ARTICLE 9

Overall, the deposit account provisions give great flexibility to depositary banks. The automatic perfection rules, combined with the retention of setoff rights and the privilege against disclosing or giving control to any other entity, clearly puts depository banks in a strong legal position. How will they react?

A. Universal Taking of Security Interest in Deposit Agreements

Given the ease with which a depositary bank can acquire a security interest and given the large potential benefits, I predict that banks will place language granting a security interest in deposit accounts in all their deposit account agreements. This language can be as innocuous as placing something like the following in all business banking accounts: "Depositor hereby grants a security interest in the deposit account hereby created to secure all present and future obligations owed to Bank."

But what if the bank does not want to assess, on a case by case basis, whether an account is used "primarily" for business or consumer purposes? As I indicate later,\textsuperscript{230} many small businesses seem to engage in the ill-advised practice of not creating a separate legal entity with which to conduct business. It would be administratively easy to simply print on each new signature card the following:

Depositor hereby grants, to the fullest extent provided by law, a security interest in the deposit account hereby created to secure any and all debts owed by depositor to bank, whether now existing or hereafter created, and regardless of whether such obligations be related to the purposes for which this account is opened.

This might be inserted in consumer deposit account agreements; the "to the fullest extent provided by law" would exclude those accounts

\textsuperscript{227} See id. § 9-104(a)(3).
\textsuperscript{228} See id. § 9-327(4).
\textsuperscript{229} See id. § 9-340(c).
\textsuperscript{230} See infra text accompanying note 249.
"primarily" used for consumer purposes.  

Moreover, since there is no signed writing requirement for attachment of an interest in a deposit account, many banks may take advantage of provisions in their deposit agreements and simply notify their customers of the change, along with an option to close the account if the customer does not agree to the change.

Although a debtor might have some defenses based on the nature of the deposit agreement as an adhesion contract and the consequences being unanticipated or contrary to expectations, that is a weak argument especially if the debtor is somehow engaged in business and presumptively able to fend for herself. Most of the law regarding amendments by waiver or estoppel are consumer cases in which concerns regarding consumer protection tend to skew the analysis.

As a consequence, most banks will immediately change their deposit agreements to provide for a security interest, and every debtor counsel will have to assume that such security interests are in place.

B. Universal Requests for Subordination Agreements

Debtors are not the only ones affected. Many lenders are not banks and, thus, cannot maintain or hold the deposit accounts of their debtors. Given the presumed universality of the grant of a security interest, most non-bank lenders (such as asset-based lenders) will not lend to debtors unless the debtor provides a subordination (or better yet, a control) agreement for each and every deposit account the debtor has. In addition, such loan agreements will undoubtedly provide for increased monitoring of debtor activity (the cost of which the debtor will bear) to ensure that the debtor does not create any new deposit accounts and divert collateral proceeds into them.

231. Such an action might work under Revised Article 9, but its efficacy under various state consumer protection or unfair trade practices law would have to be examined on a state by state basis.

232. See RESTATEMENT (SECOND) OF CONTRACTS § 211 (1981) (regarding contract of adhesion). See generally 12 C.F.R. pt. 226, Supp. I (1999) (Official Staff Interpretation Under Regulation Z on 12 C.F.R. § 226.12(d)(2)) (suggesting that taking security interest in deposit account to secure credit card obligation must be specifically intended by cardholder, which could be shown by separately initialing the grant, by placing the security grant on a separate page, or by referencing the deposit account by identifying number or by a minimum balance).

233. See, e.g., Badie v. Bank of America, 79 Cal. Rptr. 2d 273, 289 (Cal. Ct. App. 1998) (unilateral amendment to credit card agreement adopting binding arbitration not valid against consumers notwithstanding fact that original agreement allowed bank to change terms by notice to customer).
Depositary banks will, in the long run, accept such agreements, but can also be expected to pass along any increased costs for such agreements given section 9-342's privilege against following its customer's desires in this regard.

C. Global Deals Among Non-Bank Secured Parties and Banks

The cost of negotiating and entering into individual subordination agreements will likely create incentives for non-bank lenders and bank lenders to form alliances. These alliances will be based on standard terms of subordination or control with respect to deposit accounts and will likely standardize the terms and the costs to be paid by the debtor for each such agreement entered into.

IV. POSSIBLE PROBLEMS WITH REVISED ARTICLE 9'S TREATMENT OF DEPOSIT ACCOUNTS

If private markets react by creating a web of agreements as indicated above, is all well? I wonder. As complete as it purports to be, the implementation of the decision to bring deposit accounts within Article 9 is not without some problems. Most of these are practical; that is, while the text of Revised Article 9 may be internally coherent, the application of that text to the world of commerce may have a few bumps.

A. Problems with Coverage and Choice of Law

Revised Article 9's choice of law provisions related to deposit accounts seem to have a displaced focus. By this, I mean that they seem to be drafted for the statute books of those states which have not yet adopted Revised Article 9 in that they seem to bend over backwards to direct a court to a state agreed to by the parties or in which the depositary bank is located. This is particularly apparent if the parties' agreement selects a Revised Article 9 jurisdiction; as the comments indicate, "[t]he parties' choice is effective, even if the jurisdiction whose law is chosen bears no relationship to the parties or the transaction." To assess the possible effect of this expansion, it is important to separate true conflicts from false ones. In any litigation, if a lender

234. See R. § 9-304.
235. Id. § 9-304 cmt. 2.
claims a security interest in a deposit account located in a state other than the forum state, the forum court will look to the forum state's conflicts of laws rules to resolve any dispute. If both the forum state and the state whose law the parties have selected have the same version of Article 9, then there is no problem. Each state will apply the identical version of the law.

Potential problems arise, however, when the conflict involves two states which have differing versions of Article 9. There are four possibilities to consider. The first arises if the forum state is a Revised Article 9 state, and the security agreement governing the deposit account selects nonforum and, hence, non-Revised Article 9, law. Here, if the parties have chosen non-Revised Article 9 law, that law will likely govern, and the secured party will be held not to have an interest in the deposit account for the simple reason that it agreed to law which did not recognize such interests.

A second possibility is that the parties select forum law (assumed to be Revised Article 9) to govern a deposit account that is set up and maintained in a nonforum state, and the nonforum state does not recognize security interests in deposit accounts. The issue here is whether the forum state will recognize the existence of a property interest when such an interest would not be recognized in the other state—in short, whether the forum state will tolerate different results depending on the court in which the parties litigate the dispute. This is not much different than if a married couple in a community property state attempted to take title to valuable personal property as tenants by the entireties and thereafter moved to an entireties state and asserted immunity against a creditor of only one of the spouses. Would the forum state respect the property laws of the nonforum state, and its effect on creditors, in a way that alters third party rights? The answer is not clear to me.

236. Throughout this section, I assume the issue is one of a security interest in a deposit account as original collateral and that issues of proceeds are not considered. This could occur, for example, if a bank took a security interest in a deposit account that did not contain any proceeds of any security interest.

237. If the security agreement is silent, the court will then turn to Revised section 9-304's default rules and will look to see where the account was set up or, barring all else, where the bank's chief executive office is located. See R. § 9-304(a).

238. There is often good reason to do this: many states recognize such property as immune from the claims of creditors of just one spouse. See, e.g., Crawford v. United States Fidelity & Guar. Co., 139 So. 2d 500, 503 (Fla. Dist. Ct. App. 1962) (personal property can be held as tenants by the entireties and when so held is immune from execution and levy by a creditor of only one of the spouses); Pitts v. United States, 408 S.E.2d 901, 904-05 (Va. 1991) (notes received in sale of real property held as tenants by the entireties kept entireties character; therefore, creditor of only one spouse could not execute on notes).
The questions become more complicated when the forum state has not adopted Revised Article 9, and the parties' agreement adopts, as to deposit accounts, the law of a jurisdiction that has adopted Revised Article 9.\textsuperscript{239} In this case, the forum state will likely apply section 1-105 as the test for validation of the choice of law clause.\textsuperscript{240} Under section 1-105, however, the parties may agree to apply a particular state's law only when "a transaction bears a reasonable relation to this state and also to another state."\textsuperscript{241} Simply choosing a state for its law, however, is likely not a sufficient basis under section 1-105,\textsuperscript{242} especially when such a choice affects not only the rights of the parties \textit{inter se}, but also the rights of third parties. Thus, if the only connection to a state is the parties' selection of it in their agreement, it is doubtful that section 1-105, as it is currently read, will validate it.

Note, however, that none of these resolutions turns on a reading of Revised section 9-304. This brings me back to my opening assertion: the provisions of Revised section 9-304 would make life a lot easier if they were in the laws of non-Revised Article 9 states. But they are not, and the choice of law provisions thus seem, at least domestically,\textsuperscript{243} to not have much ultimate impact.

The question turns on whether the state where the dispute is decided will honor the property interest in the deposit account, and proceeds, created under the law of another state. If the two states at issue have both adopted Revised Article 9, then there is no issue,
since the law has the same text in both places. If, however, the state where the dispute arises has not adopted Revised Article 9, then the fate of the secured party's interest is less secure.

B. Definitional Problems

In order to avoid problems with consumer protection concepts, Revised Article 9 limits a debtor's ability to grant a security interest in deposit accounts by excluding "an assignment of a deposit account in a consumer transaction." While this exclusion covers most consumer deposit accounts, it may not be sufficiently clear at the margins to avoid problems, and the margins (that is, the number of affected cases) may be wide.

The problem stems from the definition of "consumer transaction." This definition would permit the inclusion of some consumer accounts; a consumer transaction is one that is primarily, not exclusively, for personal, family, or household purposes. Thus, a deposit account held by a sole proprietor may be subject to a security interest if the bank's standard deposit agreement takes a security interest in it, even if the proprietor also uses the account to buy the weekly groceries.

This may occur more often than may have been thought. By recent counts, somewhere between 10% and 15%, and perhaps as much as 36%, of all chapter 11 bankruptcy cases are filed by individuals. When combined with business chapter 13 filings, it may be that individuals are the debtors in almost 61% of all business

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244. R. § 9-109(d)(13).
245. See id. § 9-102(a)(26).
246. Troublesome issues regarding the preservation of exemption rights in deposit accounts would also arise, especially since most exemption laws permit the encumbrance of exempt property pursuant to a consensual security interest. See Sepinuck, Defense, supra note 19, at 535-37. But see 42 U.S.C. § 407(a) (1994) ("The right of any person to any future payment under this subchapter [regarding social security payments] shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law."); Ellender v. Schweiker, 575 F. Supp. 590, 599 (S.D.N.Y. 1983) (holding that section 407(a)'s ban extended to voluntary assignments executed before receipt of funds, even when Secretary of Health, Education and Welfare had issued contrary regulations), appeal dismissed, 781 F.2d 314 (2d Cir. 1986).
249. Only individuals may be debtors under chapter 13, see 11 U.S.C. § 109(e) (1994), and chapter 13 relief expressly contemplates that some individuals may reorganize a business in a chapter 13, see 11 U.S.C. § 1304(b).
bankruptcies—a total of some 13,500 cases per year. These cases will likely present easy issues—but tough results—regarding whether a checking account used for both family and business is used "primarily" for consumer purposes. Under a plain reading of Revised Article 9, it is not and, thus, the family's operating funds will be subject to the bank, along with the likely loss of any state law exemptions the family might have claimed.

This problem will be more troublesome if banks, as a policy matter, adopt general language for taking security interests in all their deposit agreements. In short, if there are as many mixed accounts supporting budding but incompetent entrepreneurs, then I suspect that the effort to exclude consumers will result in a form of an ignorance tax, in which consumers trying to start their own business will unwittingly wind up giving their bank more than they believed they were or that they wanted.

C. Definitional Problems With a Bite—Residential Mortgages and Bankruptcy Cramdown

There are other practical reasons for banks to worry about sweeping up sole proprietors' deposit accounts with broad language. One of the earliest forms of securitization involved the market in notes secured by homes. Indeed, the Government National Mortgage Association—better known as "Ginnie Mae"—has securitized over $1 trillion dollars of mortgage-backed securities during its history. Although a tale better told elsewhere, the Bankruptcy Code treats holders of home mortgages differently than anyone else. While other secured creditors risk cramdown if the value of the security dips below the amount of their debt, that is not the case with mortgages

250. See Warren & Westobrook, supra note 248. This number is the combined number of interpolated individual chapter 11s with the actual number of business chapter 13s for the 1997 calendar year.
252. This is a practical problem only to the extent that banking and lending relationships are consolidated and to the extent that security interests in bank accounts have advantages over the existing remedies of setoff.
255. Technically, the plan "modifies" the debt so that the secured creditor receives a payment stream over the life of the plan which is equal to the present value of the collateral, not the present value of the debt. See 11 U.S.C. §§ 1322(b)(2) (permitting modification in plan),
secured by homes. Chapter 13 is explicit on this. Under section 1322(b) of the Bankruptcy Code, which contains a list of permissible plan provisions, it allows chapter 13 debtors to modify the rights of holders of secured claims. other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims.256

As a consequence, chapter 13 debtors may not modify a home mortgage loan in most cases. The exceptions, however, are key. The statutory exception applies only to "claim[s] secured only by a security interest in real property that is the debtor's principal residence."257 Courts have construed the modifier "only" to mean just that; if the lender takes other real property security258 or any other personal property security, it loses the protection of section 1322(b)(2).259 The loss of this exception has even been found when the lender took an interest in a deposit account under non-UCC law.260

Lenders should, thus, think twice before unthinkingly inserting blunderbuss provisions granting security interests in agreements governing deposit accounts, lest they lose the ability to sell the real estate loans they generate in the secondary market. A better course of action would seem to be to put such provisions in agreements related to business accounts only and to keep them out of consumer deposit agreements entirely.261


256. Id. § 1322(b)(2) (emphasis added). Chapter 11 has a similar section, added in 1994. See id. § 1123(b)(5).

257. Id. § 1322(c)(2) (emphasis added).

258. See In re McVay, 150 B.R. 254, 257 (Bankr. D. Or. 1993) (majority of space in property securing debt was used as bed-and-breakfast establishment); In re Ramirez, 62 B.R. 668, 668-69 (Bankr. S.D. Cal. 1986) (claim also secured by property used for rental); In re Morphis, 30 B.R. 589, 594 (Bankr. N.D. Ala. 1983) (claim also secured by adjoining vacant lot could be modified).

259. See, e.g., Caster v. United States (In re Caster), 77 B.R. 8, 10 (Bankr. E.D. Pa. 1987) (loss of exception when claim also secured by appliances); In re Lapp, 66 B.R. 67, 69 (Bankr. D. Colo. 1986) (loss of exception when claim also secured by irrigation equipment); In re Simpkins, 16 B.R. 956, 972 (Bankr. E.D. Tenn. 1982) (loss of exception when claim also secured by debtors' motor home).

260. See In re Libby, 200 B.R. 562, 567 (Bankr. D. N.J. 1996) (provision in loan agreement that took security interest in "all money, securities and other personal property on deposit or in [the secured party's] possession or control" held to deprive lender on residential mortgage of benefit of section 1322(b)(2)'s exclusion, even when lender held no actual security matching the description).

261. Courts have also held that a secured party cannot release the additional security after the bankruptcy has been filed; rather, a court will look at the state of security as of the date of filing. See Johns v. Rousseau Mortgage Corp. (In re Johns), 37 F.3d 1021, 1025 (3d Cir. 1994); In re Baksa, 5 B.R. 184, 187 (Bankr. N.D. Ohio 1980).
D. Problems with Attachment

Revised Article 9 adopts the notion of attachment by nonwritten agreements.\(^{262}\) This adoption presumably borrows from the law of possessory security interests, which presently do not require a writing, or in the new parlance of Revised Article 9, a record.\(^{263}\) With tangible goods, part of the justification is that possession of the goods by someone other than the debtor is itself sufficient evidence of the intent to create a security interest and that disputes are, thus, less likely.\(^{264}\)

I question whether this is sufficient for deposit accounts. When an entity no longer possesses a good, this lack of possession justifies the belief that the "owner" no longer has the full panoply of ownership interests. The reason for this position turns, in part, on the fact that the owner of goods usually possesses them. Initially then, one should question whether justifications based on such assumptions carry over cleanly to deposit accounts.

No one expects a debtor to maintain its own deposit account; indeed, unless the debtor is itself a bank, it simply cannot happen. This difference casts doubt on whether the inference that a lack of "possession" of a deposit account automatically should put creditors on notice that someone other than the debtor claims an interest in that deposit account. It may be that the historic rights of setoff may have created the necessary context, but since Revised Article 9 does not purport to affect setoff rights, the inference is not a complete one.

In short, it may be that the casualness of attachment will lead to the type of disputes that statute of frauds type legislation were intended to prevent. The comment to Revised section 9-204 classes deposit accounts with other types of security for which control is necessary to perfect: investment property, electronic chattel paper, or a letter-of-credit right. It then states that "control . . . satisfies the evidentiary test if control is pursuant to the debtor's security agreement."\(^{265}\)

In each of these cases, however, there typically is someone other than the bank involved in a prototypical transaction. Put another way,

\(^{262}\) See supra Part II.B.1.

\(^{263}\) UCC section 9-203(1)(a) requires no writing for attachment of a possessory security interest; all that is required is that "the collateral is in the possession of the secured party pursuant to agreement."

\(^{264}\) See U.C.C. § 9-203 cmt. 3.

\(^{265}\) R. § 9-203 cmt. 4.
in the other types of transactions, third parties would normally look to someone other than the person in "control" for clues as to the true ownership of the collateral. When combined with the inevitable differences in memory as to whether, and to what extent, the debtor granted a security interest in a deposit account, it is regrettable that the record requirement was not extended to the creation of security interests in deposit accounts.266

E. Tracing

Tracing is essential under Current Article 9 in order to identify cash proceeds and, thus, maintain perfection in proceeds once they are deposited into a deposit account.267 Revised Article 9 carries through this importance, but fails to identify a particular method for tracing, or identifying, proceeds into deposit accounts. As Professors Barnes and McLaughlin have pointed out, the current state of the law is fairly settled, with most courts adopting some form of the lowest intermediate balance test.268

The problem, however, is in my use of the modifier "most." With perfection turning on such an indefinite common law concept, it is to be lamented that the drafters of Revised Article 9 did not adopt or at least articulate a presumption in favor of one form of tracing over another.269 In a sense, we want tracing to accomplish the impossible: the allocation and division of a unified and indivisible obligation. Put another way, tracing attempts to give property attributes to intangible obligations. Given the strong base of property law that underlies

266. The problem also exists in Revised Article 8, which also seems to allow control by nonrecorded means. See U.C.C. § 8-106(d).

This problem of a lack of a record could be exacerbated by practices that attempt to amend a deposit account agreement by estoppel; that is, if banks send notices of change to customers which take effect in the absence of the closing of the account.

On the other hand, if banks routinely insert security interest grants in the original deposit agreements, perhaps the issue will never arise, or perhaps banks will take the position that their historic rights of setoff have altered typically understandings about control, possession, and the ability of third parties to reach a debtor's assets.

267. See U.C.C. §§ 9-306(2) (security interest attaches only in identifiable proceeds), 9-306(3)(b) (security interest remains perfected beyond ten-day grace period only in "identifiable cash proceeds" such as deposit accounts).

268. See Barnes, supra note 27, at 331-32 & n.190; McLaughlin, supra note 19, at 46 n.7.

269. In California, for example, the legislature has adopted the lowest intermediate balance test as presumptively correct when determining how much of a debtor's bank account is allocable to exempt proceeds. See CAL. CIV. PROC. CODE § 703.080(c) (West 1987) ("The tracing of exempt funds in a deposit account shall be by application of the lowest intermediate balance principle unless the exemption claimant or the judgment creditor shows that some other method of tracing would better serve the interests of justice and equity under the circumstances of the case.").
Revised Article 9's treatment of deposit accounts, something more should have been offered.

F. Possible Circular Priority Issues

Circular priority is a favorite of law professors.270 Up to now, it has been mostly a theoretical problem.271 By introducing nontemporal priority for perfection of deposit accounts, however, I think Revised Article 9 potentially creates the potential for havoc in many bankruptcies.

I base my fears on the following hypothetical. Debtor, D, has a secured line of credit with asset-based lender, A. A has a properly perfected, and unavoidable in bankruptcy, security interest in D's inventory and all proceeds thereof. In addition, it is oversecured. D also has an account with Bank B, and B has a clause in its standard form deposit agreement granting B a security interest in the deposit account to secure all obligations running from D to B. Further assume that D owes B money and that the obligation exceeds the amount in the deposit account; that is, B is an undersecured creditor. Finally, assume that A and B have entered into an agreement pursuant to which B agrees to subordinate its security interest in the account to A's interest.

Now assume that D sells inventory and deposits the proceeds in the account at B and such amount is traceable under local law. Immediately after the funds clear, D files for bankruptcy.

As against the trustee, A's interest in the proceeds is perfected as identifiable proceeds of the sale of the inventory. As against B, however, A loses, since B has control of the account.272 But since B was undersecured, the transfer of the funds to B is preferential.273 It


271. See, e.g., Alvin C. Harrell, UCC Article 9 Drafting Committee Considers October 1996 Draft, 51 CONSUMER FIN. L.Q. REP. 54, 54-55 (1997) (reporting that Article 9 Drafting Committee thought that circular priority issues, raised by other sections of Revised Article 9, were rare in practice and handled well by courts when confronted and, thus, could be treated by commentary).

272. See R. § 9-322(c).

273. As stated in Collier.

Payments to a partially secured creditor from property not covered by its lien, however, have a preferential effect, because in a chapter 7 liquidation, that creditor would receive a distribution for the full value of its secured claim, in addition to the
can thus be set aside by the estate representative, either the debtor's trustee in bankruptcy or the debtor in possession.274

After avoidance, the trustee steps into B's position. Section 551 states that "[a]ny transfer avoided . . . is preserved for the benefit of the estate."275 With the benefit of this statute, the trustee will take over B's position, and thus have priority over A with respect to the proceeds. The end result is the effective avoidance of A's interest in all proceeds on deposit at Bank B (even though outside of bankruptcy such proceeds were protected against lien creditors), simply because another creditor, Bank B, happened to be undersecured at the time of the filing.

A defense to this argument might be that an obligation such as a deposit account is unitary. Thus, its date of transfer, for bankruptcy purposes, would be the date of its creation, not the date of each deposit. Each deposit would be analogized to a separate increase in value of the encumbered asset, the deposit account, rather than a separate and discrete transfer in its own right. This defense would analogize deposits into the bank account to installment payments under a executory contract to deliver goods or services. Bankruptcy courts have generally held that when a debtor has granted a security interest in an executory contract prepetition, payments earned and made after filing are proceeds of that contract.276 As such, they are payments already received. In other words, the payment would ordinarily be applied to the unsecured portion of the undersecured debt, but would not reduce the lien or increase the debtor's equity in the collateral.

5 COLLIER ON BANKRUPTCY, supra note 29, ¶ 547.03[7] (footnote omitted); see Porter v. Yukon Nat'l Bank, 866 F.2d 355, 359 (10th Cir. 1989); Barash v. Public Fin. Corp., 658 F.2d 504, 508-09 (7th Cir. 1981); Vern Countryman, The Concept of a Voidable Preference in Bankruptcy, 38 VAND. L. REV. 713, 744 (1985) ("That result could be avoided. The creditor could apply the payment to the secured part of his claim by releasing a corresponding amount of collateral. But there is no recorded instance of a partially secured creditor doing so. Instead, the creditor always takes the payment and retains all of his collateral." (footnote omitted)).

274. Section 547 gives the power to avoid preferences to the trustee, and section 1107 of the Bankruptcy Code gives the chapter 11 debtor in possession the powers of a trustee with respect to such avoiding powers actions. See 11 U.S.C. §§ 547(b), 1107(a) (1994).

275. Id. § 551.

276. The classic case is Rockmore v. Lehman, 129 F.2d. 892 (2d Cir. 1942). Many recent cases follow it with respect to the identity, as proceeds, of postpetition payments on executory contracts entered into prepetition when the debtor had granted a prepetition security interest in the executory contract. See Smoker v. Hill & Assocs., Inc., 204 B.R. 966, 975 (N.D. Ind. 1997) (insurance commissions earned and paid postfiling by a chapter 13 debtor were proceeds of a prepetition security interest created by a grant of a security interest in insurance commissions "now due or that hereafter may become due," and thus not subject to section 552(a)); In re Patio & Porch Sys., Inc., 194 B.R. 569, 574 (Bankr. D. Md. 1996) (payments earned and paid on postpetition home improvement contracts were proceeds of a prepetition security interest in "accounts receivable," and hence outside of section 552(a)); In re Rumker, 184 B.R. 621 (Bankr. S.D. Ga. 1995) (chapter 13 debtor's unearned postpetition compensation from court-awarded
exempt from the general cutoff of security interests under section 552(a) of the Bankruptcy Code.\footnote{277}

If this analogy holds, then any deposits made are proceeds, and the transfer of the security interest related to each occurred at the inception of the account. If the account was established beyond the preference reachback period,\footnote{278} the deposits would then not be preferential. since under this theory the transfer of the debtor's interest in property, required for a preference,\footnote{279} occurred outside the preference reachback period. In brief, B would argue that the deposit account was no different from a static asset, such as a lump of gold, which increased in value immediately before D's filing.

The problem with this approach is that Revised Article 9 itself treats each deposit as a new transfer. By adopting tracing and by permitting a secured party to use tracing techniques to allocate a part of a deposit account as its proceeds collateral, Revised Article 9 preserves, at least to some extent, the separate identity of each deposit, even though it has become part of the depositary bank's undivided obligation. In this way, Article 9 harkens back to the origins of deposit accounts and treats them as property by authorizing division of the bank's undivided obligation to its customer to be divided as if it were tangible property. Under this analysis, each deposit would be a separate transfer (since the debtor would not have rights in it until deposit) and, thus, each transfer would have to go through a separate perfection analysis. In short, tracing divides the indivisible nature of the bank's obligation, ensuring that the debtor's separate and discrete deposits do not lose their discrete character upon deposit.\footnote{280} Indeed, the whole concept of control as a means of perfection rests on the shaky theoretical basis that the bank has the

\footnote{277}{Under section 552(a) of the Bankruptcy Code, security interests in after-acquired property are cut off and terminated. \textit{See} 11 U.S.C. § 552(a). Section 552(b), however, provides that the termination of section 552(a) is not applicable to the extent that the postpetition property is "proceeds" of a prepetition security interest. \textit{See id.} § 552(b)(1).}

\footnote{278}{This period is normally 90 days unless the recipient of the transfer was an insider (as defined in section 101(31) of the Bankruptcy Code), in which case the reachback period would be a year. \textit{See id.} § 547(b)(4).}

\footnote{279}{\textit{See id.} § 547(b).}

\footnote{280}{To a certain extent, other federal law recognizes this aspect of deposit accounts. Regulation CC, 12 C.F.R. § 229 (1998), obligates banks to make funds available to depositors on the basis of what type of check the debtor deposited and when the debtor deposited it. This is so even though there is not necessarily a connection between payment of the check by the payor bank and the required availability of funds.}
ability to exclude others from the account, a property law concept. Thus, so the estate representative would counter, a deposit account is not like one gold nugget, but rather like a series of nuggets, with the transfer of each nugget being a separate transfer for purposes of preference law, and tracing being the method of disaggregating the nuggets from the pile.

Another defense might be that the deposit of the check into the deposit account was not a transfer and, thus, could never be a preference. This argument turns on court interpretations that "to the extent a deposit is made into an unrestricted checking account, in the regular course of business and withdrawable at the depositor's will, it is not avoidable by the trustee." There is a kernel of an idea here, but it lies not in the categorization of the deposit as a nontransfer. The definition of a "transfer" under the Bankruptcy Code is broad enough to pick up the transfer of funds represented by the deposit as a transfer, and even the legislative history indicates that "[a] deposit in a bank account or similar account is a transfer." Rather, the idea is that avoidance of the transfer will not benefit the estate. As stated in Collier, a deposit

281. The allowance of oral security agreements for deposit accounts, see supra Part II.B.1, also evidences the treatment of a deposit account as if it were a tangible asset, capable of possession.

282. This is supported by 11 U.S.C. § 547(e)(3), which states that a transfer cannot occur until the debtor has rights in the property transferred. See Deardorff v. Ford Motor Credit Co. (In re Deardorff), 195 B.R. 904, 911 (Bankr. W.D. Wis. 1996) (fact that wage garnishment order entered more than 90 days before bankruptcy did not protect wages paid within 90 days); Canfield v. Simpson (In re Jones), 47 B.R. 786, 791 (Bankr. E.D. Va. 1985) (although garnishment was outside of preference reachback period and, thus, transfer of funds outside that time was not preferential, deposits made to bank account within 90 days of bankruptcy were transfers and thus preferential). But see In re Wilkinson, 196 B.R. 311, 323 (Bankr. E.D. Va. 1996) (execution lien obtained more than 90 days prepetition covered wages paid within 90 days of petition).


284. Under the Bankruptcy Code, a "transfer" is defined as: every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption.


286. See Citizens' Nat'l Bank v. Lineberger, 45 F.2d 522, 526-29 (4th Cir. 1930). Under current law, the argument would be that the lack of benefit would mean a failure under section 547(b)(5) which requires the transfer to allow the creditor to receive more, as a result of the transfer, than it would have in a chapter 7 liquidation. See 11 U.S.C. § 547(b)(5)(A). This view equates lack of estate benefit with the test in section 547(b), but this could be criticized textually; it would exclude from preferential recoveries those transfers which affect only the recovery of two creditors inter se, and not the general creditor body.
may be withdrawn at the will of the depositor, and does not operate to diminish the depositor's estate. The ordinary deposit results in substituting for currency, bank notes, checks, drafts and other bankable items, a corresponding credit with the bank which may be withdrawn, and which provides the depositor with the medium of exchange in the transaction of business.\textsuperscript{287}

The cases supporting this view, however, assume that the debtor will have "unrestricted" access to the funds once deposited.\textsuperscript{288}

Before Revised Article 9, the diminished access to the account by reason of the bank's setoff was handled by section 553 of the Bankruptcy Code. With Revised Article 9, however, many of the cases that justify the "no preference" view seem suspect; they indicate, in dicta, that a transfer for security would not give the debtor "unrestricted" access.\textsuperscript{289} To a certain extent, this makes sense. Each deposit increases the amount of security available to the depositary bank, to the detriment of at least one other creditor. Moreover, to the extent that the basis of perfection for the depositary bank is "control," then that also seems at odds with the underlying theory of unrestricted access. The transfer thus seems preferential.

Is there a defense? There might be. In response to similar problems with floating liens in inventory and receivables,\textsuperscript{291} Congress enacted section 547(c)(5).\textsuperscript{292} In essence, this section dispenses with a

\textsuperscript{287}. 5 COLLIERS ON BANKRUPTCY, supra note 29; \textsuperscript{288}. See Gilbert v. First Nat'l Bank, 633 F.2d 686, 689 (5th Cir. Unit A 1980); Pioneer Liquidating Corp. v. San Diego Trust \& Sav. Bank (\textit{In re Consolidated Pioneer Mortgage Entities}), 211 B.R. 704, 714-15 (S.D. Cal. 1997), aff'd in relevant part, 166 F.3d 342 (9th Cir. 1999).
\textsuperscript{289}. See, e.g., New York County Nat'l Bank v. Massey, 192 U.S. 138, 147 (1904) ("[A] deposit of money to one's credit in a bank does not operate to diminish the estate of the depositor, for when he parts with the money he creates at the same time, on the part of the bank, an obligation to pay the amount of the deposit as soon as the depositor may see fit to draw a check against it. It is not a transfer of property as a payment, pledge, mortgage, gift or security." (emphasis added)); New Jersey Nat'l Bank v. Gutterman (\textit{In re Applied Logic Corp.}), 576 F.2d 952, 962 (2d Cir. 1978) (setoff); \textit{Citizens' Nat'l Bank}, 45 F.2d at 527-28 (if deposit is a "cloak for some other transaction, such as payment or the giving of security; ... equity, which looks through form to substance, will treat the transaction according to its real nature" (emphasis added)).
\textsuperscript{291}. The problems were noted by the pre-Code cases of \textit{DuBay v. Williams}, 417 F.2d 1277 (9th Cir. 1969), and \textit{Grain Merchants, Inc. v. Union Bank & Savings Co.}, 408 F.2d 209 (7th Cir. 1969). The rationale of these cases was overruled by the adoption of 11 U.S.C. § 547(e)(3), but their spirit was attempted to be captured in 11 U.S.C. § 547(c)(3).
\textsuperscript{292}. Section 547(c)(5) states that:

The trustee may not avoid under this section a transfer—

(5) that creates a perfected security interest in inventory or a receivable or the proceeds of either, except to the extent that the aggregate of all such transfers to the transferee caused a reduction, as of the date of the filing of the petition and to
transfer by transfer analysis in favor of looking at the aggregate effect of all transfers during the applicable reachback period. This analysis first looks to see if the effect of all transfers during the reachback period was to better the position of the secured creditor. If not, then section 547(c)(5) provides a defense to the recipient, even if individual transfers might have been preferential. If, however, the position is bettered, then section 547(c)(5) gives a defense only to the extent necessary to preserve the recipient's position at the beginning of the reachback period. In other words, the estate will be able to avoid the security interest in receivables and inventory existing on the date of the bankruptcy petition to the extent the aggregate effect of all the transfers was to better the secured party's position.

By way of example, assume that a debtor owed an inventory lender $1000 throughout the ninety days preceding the filing of a bankruptcy case. As of the date ninety days before the filing, its collateral (inventory) was worth $600. At the date of filing, it was worth $800. Although it is likely that all the inventory was sold and restocked during this period, not every transfer of inventory is avoided. The secured party has a defense to the extent of its original position ninety days before bankruptcy; that is, to the extent of $600. This means that $200 worth of the security interest is avoided as preferential.293

How does this apply to security interests in deposit accounts? Section 547(c)(5) is a limited defense. It only applies to transfers which create a security interest. And then only to the extent that the security interest is in inventory or receivables. The possible saving point here is in the definition of "receivable." For purposes of this section only, the Bankruptcy Code defines receivable as a "right to payment, whether or not such right has been earned by performance."294 As indicated above,295 a deposit account is nothing

the prejudice of other creditors holding unsecured claims, of any amount by which the debt secured by such security interest exceeded the value of all security interests for such debt on the later of—

(A) (i) with respect to a transfer to which subsection (b)(4)(A) of this section applies, 90 days before the date of the filing of the petition; or

(ii) with respect to a transfer to which subsection (b)(4)(B) of this section applies, one year before the date of the filing of the petition; or

(B) the date on which new value was first given under the security agreement creating such security interest.

293. I assume here that the inventory lender is not able to trace the acquisition of all new inventory to proceeds of prior sales.
295. See supra note 2.
more than an obligation of the bank maintaining the deposit to pay out funds pursuant to the depositor's order; in short, it would appear to fit into the expansive definition of "receivable" contained in section 547(a). Although this does not remove the preference problem, it has the tendency to minimize it.

G. The Price of "Control"

In borrowing the concept of control from investment securities, Revised Article 9 opens up serious questions regarding the banking relationship. In this respect, I refer particularly to the secured party's becoming the depositary bank's customer, as anticipated in section 9-104(a)(3). In some cases, such as nonoperating accounts or investment accounts, this treatment may make sense. But when the debtor's business requires some access to the funds, is this scheme practical?

In essence, the issue resolves into whether the debtor can issue checks or other orders under its signature that the depositary bank is obligated to honor, even though the debtor is no longer the bank's customer. Put another way, can one be a drawer on a check but not the customer of the drawee? The current structure of Article 4 does not explicitly anticipate this, and one might have to draw analogies to the signing authority of corporate agents; in short, the secured party might be the customer, but it can give temporary and unilaterally revocable agency rights to the debtor to sign checks drawn on the account.

Even if workable, such an arrangement begs the question of


297. Another practical question arises if the deposit account is interest bearing. The issue is who the bank will report as the recipient of such income for tax purposes, such as when the depositary bank must send out its 1099 forms. See generally 26 C.F.R. § 1.6041-1 (1998) (collecting rules regarding reporting of interest). If the secured party has the interest credited to the deposit account itself, it would seem that the secured party, as the customer on the account, should be named on a Form 1099 filed by the bank. See id. § 1.6049-4(b)(1) ("[A]n information return on Form 1099 shall be made for the calendar year showing the aggregate amount of the payments, the name, address, and taxpayer identification number of the person to whom paid . . . ." (emphasis added)).

298. There may be a lingering question as to whether the secured party is not only the customer, but also the drawer with respect to the checks. UCC section 3-103(a)(3) identifies the drawer not only as the person who signs the check, but also as the person "who is identified in a draft as a person ordering payment." Thus, if the secured party's name appears on the check, it may well incur liability as a drawer, since inclusion of their name would "identify[y] [them] in a
who truly owns the funds in the deposit account. If the debtor retains any ownership interest, that interest will become part of its bankruptcy estate upon filing, with all the attendant headaches that might cause. Thus, opting for control by becoming a customer does not eliminate bankruptcy problems.

If the secured party’s position is that the debtor has no interest in the account and, thus, it would not be part of any bankruptcy estate, then questions are raised as to the vulnerability of the transfer of the funds to the bank. A bank might take this position by asserting that all deposits into the account in its name are transfers to the bank as part of the overall credit arrangement and with the bank retaining the discretion to hold the funds or apply them to any secured debt.

The basic problem with this position is that unless the debtor receives “reasonably equivalent value” for the deposit of the funds in the account, the deposit transaction is potentially vulnerable under fraudulent transfer law. Under such law, if the secured party is held to have given no value because of a lack of application of the funds to the secured debt—or at least no reasonably equivalent value—for each transfer, the transaction may be set aside by the debtor’s creditors or by its representative in bankruptcy. Thus, if a secured party takes checks made payable to the debtor and deposits them in a control account upon which it is the sole customer, the secured party needs to give or have given reasonably equivalent value in order to ensure an unavoidable transfer. Fortunately, simply by giving dollar-

draft.”

In addition, to the extent that checks payable to the debtor are deposited in the account for collection (and presumably application against the debt), the bank, as customer, will make certain transfer warranties under UCC section 4-207. This should not cause many problems, however, since the bank will likely not apply any proceeds to the debtor’s outstanding loan until the checks deposited are collected.

299. See 11 U.S.C. § 541(a)(1) (estate consists of “all legal or equitable interests of the debtor in property as of the commencement of the case”).

300. If the funds are part of the estate, then the automatic stay of 11 U.S.C. § 362(a) applies to block any setoff, see id. § 362(a)(7), or any other act to collect on a prepetition debt, see id. § 362(a)(6). The secured party, however, is entitled to protection of its interest in cash collateral, see id. § 363(c)(2), and can put an administrative freeze on the account until the court has the opportunity to address the issue of adequate protection of the cash collateral, see Citizens Bank v. Strumpf, 516 U.S. 16 (1995).

301. Under the Uniform Fraudulent Transfer Act (“UFTA”), which is the law in approximately 34 states, a transfer may be avoided by creditors (and perforce by the bankruptcy trustee under 11 U.S.C. § 544(b)) if the debtor received less than reasonably equivalent value as its part of the transfer, and if before or because of the transfer the debtor was insolvent. See UNIF. FRAUDULENT TRANSFER ACT § 5(a), 7A U.L.A. 330 (1999). Under the UFTA, a transaction is vulnerable for four years. See id. § 9(b), 7A U.L.A. 359. The Bankruptcy Code has a separate provision affecting transfers occurring within one year of the bankruptcy filing. See 11 U.S.C. § 548(a)(2)(A).
for-dollar credit for the deposits (subject to collection), banks can give such value, but this may limit a bank's discretion more than it desires.

In short, upon transfer to the account, the lender needs to give some value, although it would be difficult to calculate exactly how much value would satisfy the tests of the necessary quantum of value sufficient to satisfy either the state or federal tests of "reasonably equivalent value." One wonders how this arrangement differs from the normal "lock box" arrangement under which some secured creditors require their debtors to have all payments sent to a separate address, usually a post office box, and then, pursuant to authority given in the security agreement, deposit such checks and apply the collected balances against the outstanding loan.

If no such value is given, however, it may be that secured parties unwittingly, in order to gain priority over the depositary bank, become exposed to fraudulent transfer risk, a result clearly not anticipated or desired.

In short, it appears that the "secured party as customer" option gives the secured party very little in addition to well-negotiated control or subordination agreements. Moreover, since the other party to such negotiations will always be the same—the depositary bank—it is unclear why the different form would be preferred or why the bank would, for example, give up setoff rights simply because the secured party will become the customer if it would not waive them in a separate control or subordination agreement.  

H. The Role of Setoff

The description in section 9-607 of how to enforce a security interest—by "apply[ing] the balance of the deposit account to the obligation secured by the deposit account"—is indistinguishable from a general description of setoff. Moreover, Revised section 9-340 confirms that "a bank with which a deposit account is


303. I am not the only one with such views. See BARKLEY CLARK & BARBARA CLARK, THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS § 18.07 (Supp. I 1998) ("In reality, it may be that the lender-as-customer approach is impractical.").


305. See 2 CLARK & CLARK, supra note 8, § 18.01 (describing bank setoff as "[t]he legal right of a financial institution to appropriate the deposit of its customer upon the customer's default").
maintained may exercise any right of recoupment or set-off against a secured party that holds a security interest in the deposit account."  

Is there a difference?

The short answer is that there is, and it usually works in the bank's interest. A security interest in the deposit account will create a property right to pursue and claim proceeds, whereas a setoff right, as a mere personal or contractual right, will not.  

The secured party's property right may also give it greater flexibility on default. The cases regarding joint owners of a deposit account seem to favor creditors with a security interest against only one of the joint owners, whereas the cases regarding setoff in a similar situation are a doctrinal mess. Finally, security interests under Revised Article 9 will have greater certainty of priority, especially against involuntary creditors such as the IRS.

There are some qualities, however, that make setoff appear more desirable. These appear mainly in the enforcement area. As indicated above, when a bank proceeds under its security interest, it must proceed in a commercially reasonable manner. That may not be the case with respect to setoff. As a consequence, on default, a bank with an option to proceed by setoff or by enforcement of its security interest ought to think through exactly how it is proceeding, and consider documenting that it is proceeding under the avenue offering the most advantageous consequences to it.


307. There is a possibility, however, that such a property right may destroy mutuality, one of the prerequisites for setoff. If so, then by taking a security interest, the depositary bank might lose or limit its right of setoff. See Greene, supra note 15, at 283 & n.98. The argument would be that the debt would no longer be mutual, since other creditors might be able to force the depositary bank to marshal, analogizing to the case in which the debt is owed by the debtor and the deposit account is opened by the debtor as an agent or as a trustee for another.


309. See 2 CLARK & CLARK, supra note 8, ¶ 18.06[4]; Sepinuck, Defense, supra note 19, at 512.

310. See Trust Co. v. United States, 735 F.2d 447 (11th Cir. 1984); 2 CLARK & CLARK, supra note 8, ¶ 18.14[1].

311. See R. § 9-607(c).

312. Cf. 2 CLARK & CLARK, supra note 8, ¶ 18.01 ("If the customer goes into default on its obligations, the bank is entitled to immediate satisfaction by applying the same amount from the deposit accounts—even without prior notice to the depositor—thus extinguishing the mutual debts.").
CONCLUSION

Robert Zadek has said about Revised Article 9: "‘It’s harder to work through than the old Code. There’s a huge learning curve and it’s chock-full of subtleties. If you don’t wallow in it, you could get nailed.’”313

With respect to deposit accounts, this description fairly applies. While bringing almost excruciating clarity to the subject, Revised Article 9’s provisions on deposit accounts do have complexities that bear more than one reading. The more one reads, the more one confirms that these complexities do indeed fit together, and snugly. More often than not, however, the result of these re-readings will confirm what one initially suspected: the depositary bank always wins, or at least starts out the game far ahead. This can be seen not only in rules respecting perfection by, and only by, control, but also in the reversal of current law regarding the victor in contests between proceeds claims and offset rights.

Those most directly affected by these changes will be non-bank lenders, including asset-based lenders and occasional secured parties who finance their goods on a purchase money basis. Revised Article 9 has a solution for these parties: obtain control or subordination agreements from every bank at which your debtor has, or will have, a deposit account. This solution carries with it a price, a price which includes the cost of dealing with depositary banks who begin such negotiations with a strong hand and who indeed may ignore the wishes of their customers on the topic. This price, however, far from being paid by the non-bank secured parties, will inevitably be passed along to debtors. Since existing laws that have brought deposit accounts within existing Article 9 do not impose these types of costs, we do not know whether Revised Article 9’s deposit account provisions will increase credit and reduce its cost. That is an empirical question only time and experience will answer.

APPENDIX

DEPOSIT ACCOUNT CONTROL AGREEMENT EXEMPLAR

[LETTERHEAD OF DEBTOR]

[date]

[Depositary Bank]
Re: Deposit Account Control Agreement

Ladies and Gentlemen:

We are entering into financing arrangements with [Insert Name of Lender] ("Lender"). In connection with those arrangements we, together with Lender, ask you to enter into this agreement with us regarding the control of account number(s) [Insert identifying account number or numbers], which we maintain with you ("Deposit Account").

As part of our financial arrangements with Lender, we have agreed to grant to Lender a security interest in: (a) the Deposit Account; (b) any cash balances from time to time credited to the Deposit Account; and (c) any and all proceeds of either, whether

1. Many thanks are due to Edwin Smith, Esq. of Bingham Dana LLP for permission to reprint this form, which I have taken the liberty of slightly modifying.

2. The addressee is assumed to be the depositary bank. The depositary bank has no obligation under Revised Article 9 to enter into a "control agreement" or, unless the depositary bank otherwise agrees in a writing or other authenticated record, to take or refrain from taking any other action as a result of the attachment or perfection of a security interest in favor of a third party in a deposit account maintained with the depositary bank. See R. §§ 9-341, 9-342.

3. See id. § 9-102(a)(29) (defining "deposit account"). A "deposit account" does not include "investment property" as defined in Revised section 9-102(a)(49). See id. Nor does the definition of "deposit account" include an account evidenced by an instrument, see id., as defined in Revised section § 9-102(a)(47), such as a transferable certificated certificate of deposit. Revised Article 9 includes within its scope commercial deposit accounts, including commercial checking and other commercial transaction accounts. See id. § 9-109 cmt. 16. However, Revised Article 9 generally excludes from its scope deposit accounts, whether checking or savings accounts, in consumer transactions. See id. § 9-109(d)(13).

4. If a security interest in a deposit account has attached, the security interest would appear to extend to any cash from time to time credited to the deposit account. See id. § 9-204(a).

5. The attachment of a security interest in a deposit account gives the secured party an attached security interest in identifiable proceeds of the deposit account. See id. §§ 9-203(f), 9-315. That security interest in identifiable proceeds continues perfected for 20 days and continues perfected thereafter so long as the identifiable proceeds are identifiable cash proceeds.

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now or hereafter existing or arising\(^6\) (collectively, the "Deposit Account Collateral").

In order to give Lender control over the account, as defined in [Insert Citation to Applicable State Version of Section 9-104(a)(2)], we hereby agree that Lender shall be entitled at any time to give you instructions as to the withdrawal or disposition of any funds from time to time credited to the Deposit Account, or as to any other matters relating to the Deposit Account or any of the Deposit Account Collateral.

You hereby agree to comply with any such instructions without any further consent from us and without regard to any other agreement that may exist between Lender and us.\(^7\)

We acknowledge that this agreement includes any and all instructions which Lender may deliver to you. In particular, we understand that such instructions may include the giving of stop payment orders for any items being presented to the Deposit Account for payment,\(^8\) and may include instructions to transfer funds to or for the Lender's benefit.\(^9\)

You shall be fully entitled to rely upon such instructions from Lender even if such instructions are contrary to any instructions or demands that we may give to you, even if the result of such instructions is your dishonor of items which may be presented for payment.\(^10\) In the event of any dishonor due to Lender's instructions, we confirm that you shall have no liability to us for wrongful

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6. A security interest generally may extend to after-acquired property. See id. § 9-204(a).
7. A security interest in a deposit account as original collateral must be perfected by "control." See id. § 9-312(b)(1). The above language is the key language granting to the secured party "control"—the depositary bank agrees that it will comply with instructions originated by the secured party directing the disposition of funds in the deposit account without further consent by the debtor. See id. § 9-104(a)(2).
8. The reference to stop payment orders may be necessary where the Deposit Account is a checking account or other items are to be presented to the Deposit Account for payment. The secured party, as a "person authorized to draw on the account," should be entitled to give stop payment orders. See U.C.C. § 4-403(a). Although under UCC section 4-403(a) a stop payment order from the secured party must identify the relevant items with "reasonable certainty," that requirement would appear to be met by a stop payment order on all items presented to the deposit account for payment. A stop payment order is effective for a period of six months unless the order is oral and is not confirmed in writing within 14 days. See id. § 4-403(b).
9. Upon default, a secured party may instruct a lender to transfer the balance of a deposit account to or for the secured party's benefit. See R. § 9-607(a)(5).
10. Once again, for the secured party to have "control" over a deposit account, the secured party must be able to give instructions to the depositary bank as to the disposition of funds in the deposit account without the further consent of the debtor. See id. § 9-104(a)(2).
dishonor. You shall have no duty to inquire or determine whether Lender is entitled, under any separate agreement between us and Lender, to give any such instructions. By this agreement, we acknowledge and realize that you may be instructed to transfer funds from the account at times when we may believe that the Lender is not entitled to give such instructions, and we accept that risk and request that you honor the Lender's instructions notwithstanding anything we may say to the contrary. We further agree to be responsible for your customary charges and to indemnify you from and to hold you harmless against any loss, cost, or expense that you may sustain or incur in acting upon instructions which you believe in good faith to be instructions from Lender.

Unless you have obtained Lender's prior written consent, you agree not to exercise any right of recoupment or setoff, or to assert any security interest or other lien that you may at any time have against or in any of the Deposit Account Collateral on account of any credit or other obligation owed to you by us or any other person. You may, however, from time to time debit the Deposit Account for any of your customary charges in maintaining the Deposit Account or for reimbursement for the reversal of any provisional credits granted by you to the Deposit Account, to the extent, in each case, that we have not separately paid or reimbursed you therefor.

11. Normally a bank that fails to pay an item that is properly payable wrongfully dishonors the item and may be liable to its customer for all damages proximately caused by the dishonor. See U.C.C. § 4-402.

12. Presumably, the security agreement between the debtor and the secured party will define the circumstances in which the secured party is entitled to give instructions to the depositary bank as to the disposition of funds in the deposit account. These circumstances will generally be reflected in the security agreement as an "event of default." The depositary bank need not be a party to that security agreement and should not in any event have any duty to investigate whether an event of default has occurred or to police other compliance by the secured party or the debtor with the contractual arrangements between the secured party and the debtor.

13. A depositary bank may provide provisional credits against checks and other items presented for payment from the deposit account while maintaining rights of recoupment and setoff against the deposit account. See U.C.C. § 4-201(a). In addition, the depositary bank may have other rights of recoupment and setoff. See U.C.C. § 1-103. Moreover, where a security interest in a deposit account is granted by a debtor in favor of the depositary bank, the depositary bank has "control." See R. § 9-104(a)(1). That security interest in the deposit account in favor of the debtor's depositary bank attaches and is perfected automatically. See id. §§ 9-203(b)(3)(D), 9-314(b). Absent subordination by the depositary bank, any security interest granted by the debtor to the depositary bank in a deposit account in the name of the debtor and any right of recoupment or setoff that the depositary bank has against the deposit account will prevail over a security interest in the deposit account perfected by the control of a secured party who is not the debtor's depositary bank. See id. §§ 9-327(3), 9-340. If the deposit account, however, is in the name of the secured party as the depositary bank's customer, the secured
You represent and warrant to Lender that the account agreement between you and us relating to the establishment and general operation of the Deposit Account provides, whether specifically or generally, that the laws of [Revised UCC Article 9 jurisdiction] govern secured transactions relating to the Deposit Account.14

You covenant with Lender that you will not, without Lender's prior written consent, amend that account agreement so that secured transactions relating to the Deposit Account are governed by the law of another jurisdiction.15

In addition, you represent and warrant to Lender that you have not entered, and you covenant with Lender that you will not enter, into any agreement with any other person by which you are obligated to comply with instructions from such other person as to the disposition of funds from the Deposit Account or other dealings with any of the Deposit Account Collateral.16

You further represent and warrant to Lender that you maintain no deposit accounts for us other than the Deposit Account, and you covenant with Lender that any items or funds received by you for our account will be credited to the Deposit Account.17

Until you have received instructions from Lender to the contrary, we shall be entitled to present items18 drawn on and party's security interest in the deposit account will prevail over the security interest and rights of setoff of the depositary bank but not rights of recoupment of the depositary bank. See id. §§ 9-104(a)(3), 9-327(4), 9-340(c).

14. The local law of the depositary bank's jurisdiction governs perfection of the security interest, the effect of perfection or nonperfection, and the priority of the security interest. See R. § 9-304(a). That jurisdiction may be the law specified in the deposit account agreement between the debtor and depositary bank as being the law applicable for purposes of Revised Article 9. See id. § 9-304(b)(1). Absent such a provision in the deposit account agreement, the bank's jurisdiction would be typically the jurisdiction set forth in the deposit agreement as the jurisdiction whose law generally governs the deposit account agreement. See id. § 9-304(b)(2). (If there is no deposit agreement or the deposit agreement contains no governing law clause, see Revised section 9-304(b)(3)-(5) to determine the applicable choice of law.) If the account agreement is not governed by the law of a jurisdiction which has adopted Revised Article 9, a separate legal analysis of the applicable conflict of laws rules will be necessary to determine attachment, perfection, the effect of perfection and nonperfection, and priority.

15. The law of the depositary bank's jurisdiction having been determined to be that of a Revised UCC Article 9 jurisdiction, the debtor and the depositary bank should not be permitted to change that governing law so as to require application of the laws of a new jurisdiction to determine perfection, the effect of perfection and nonperfection, and priority.

16. In the event that the depositary bank has entered into another control agreement relating to the deposit account, the conflicting security interests in the deposit account would rank according to the priority in time of obtaining control. See R. § 9-327(2).

17. This sentence is suggested depending upon the nature of the financing terms.

18. The reference to the presentation of items, see U.C.C. § 4-104(a)(9), would be advisable where the deposit account is a checking account or other items are to be presented for payment.
otherwise to withdraw or direct the disposition of funds from the Deposit Account;19 provided, however, that you and we agree with Lender that we may not, and you will not permit us to, without Lender's prior written consent, (i) withdraw any sums from the Deposit Account if the credit balance of the Deposit Account remaining would be less than $[Insert Amount] or (ii) close the Deposit Account.20

Kindly furnish to Lender, at its address indicated below, copies of all customary deposit account statements and other information relating to the Deposit Account that you send to us. We agree to pay for any excess cost this may entail.

This agreement shall (a) control over any conflicting agreement between you and us; (b) be governed by the internal law of [Insert State];21 and (c) not be construed to make Lender the drawer upon any item drawn against the Deposit Account.

If you agree to and accept the foregoing, please so indicate by executing and returning to us the enclosed duplicate of this letter.

[Signature of Debtor]

Acknowledged:

[Signature of Depositary Bank]

[Signature of Lender]

from the deposit account. If the deposit account is not a checking account and other items are not intended to be presented and paid from the deposit account, the references here and elsewhere in this form of agreement to the presentation of items and to stop payment orders should be deleted.

19. Normally the debtor, as depositary bank's customer, is entitled to direct the disposition of funds from the deposit account. This agreement would modify, in favor of the secured party, the debtor's sole rights as deposit account customer to give such directions.

20. The proviso clauses are suggested depending upon the nature of the financing terms relating to the collateral security. Perfection claimed by "control" is not defeated merely because the debtor retains the right to direct the disposition of funds from the deposit account. See R. § 9-104(b).

21. The jurisdiction chosen should be that of a Revised Article 9 jurisdiction that meets the "reasonable relationship" test of UCC section 1-105(1).