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Deposit Account Financing Under Revised Article 9

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V. DEPOSIT ACCOUNTS UNDER REVISED ARTICLE 9

A. *Overview*

Revised Article 9 includes deposit accounts as original collateral within its scope, but it excludes assignments of deposit accounts in consumer transactions from which an inference can be drawn that deposit accounts as original collateral now join deposit account proceeds as personal property within the scope of Revised Article 9.1 The comments accompanying section 9-109 (d) (13) indicate deposit account financing involving consumer accounts is left to law other than Article 9. *See* Rev. U.C.C. § 9-109(d)(13) cmt. 16, but Article 9 continues to govern consumer transactions involving deposit accounts as proceeds as provided in sections 9-315 and 9-322. *Id.* Revised Article 9 defines a consumer transaction 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 (ii) the collateral is held or acquired primarily for personal, family or household purposes. Consumer deposit accounts were excluded in part based on consumer advocacy groups' concerns that such deposit account financing would grant creditors a "powerful sledgehammer for forcing concessions from consumers in the event of a dispute over a debt allowing the creditor to "seize" the debtor's accounts, so as to force an immediate settlement of any claims or defenses the consumer may have on unfavorable terms." 2 Revised Article 9 defines deposit accounts as a "demand, time, savings, passbook, or similar

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See Rev. U.C.C. § 9-109(d)(13). The comments to Revised Article 9 support that inference since it explicitly excludes deposit account financing concerning consumer transactions leaving coverage concerning such to law other than Article 9. *See id.* § 9-109 (d) (13) cmt. 16.

2 *See* Harrell, *supra* note 10, at 71; *see also* Harris & Mooney, *supra* note 23, at 1364 (noting consumer advocacy groups were against the widespread collateralization of deposit account in consumer transactions).

account maintained at a bank, and a bank is defined 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.

Revised Article 9 rejects the intangible classification of deposit accounts asserted by courts under the common law, despite the debtor-creditor relationship between the depositor and its bank that supports that the debtor has an contract right to recover funds in the amount of that which it deposited.3 Under that relationship, the depositor does not have possessory right in the funds deposited, but has an intangible right to recover the amount of funds deposited. [Supra note 71] Its rejection of the intangible classification is most likely related to the Article 9 assignment law provisions, which allow an obligee to assign its intangible property right over the objection of its account debtor.[103] If deposit accounts were classified as intangibles, banks maintaining those accounts would be considered account debtors obligated to their depositors for an amount of funds equal to that deposited.[104] Depositors could assign their intangible chose in action property rights to third party assignees including secured creditors over the objection of their depositary banks.[105] Also, Revised Article 9 provides that an assignee of an intangible right

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3 Rev. U.C.C. § 9-102(a) cmt. 5d.

[103] *See* Rev. U.C.C. § 9-406(f). Section 9-406 limits assignments to transactions involving account debtors. *Id.* Revised Article 9 classifies an account debtor is one obligated on "an account, chattel paper, or general intangible." *See id.* § 9-102(a)(3).

[104] Comment 5(d) of Revised Article 9 states that excluding deposit accounts from the category of intangible personal property exempts banks from the account debtor status. *See id.* § 9-102(a) cmt. 5(d) (2001).

[105] *See id.* § 9-406(f).

can perfect its interest by filing a financing statement.[106] To categorize deposit accounts as intangibles would provide creditors, as assignees, the luxury of perfecting such accounts over the objection of the bank by filing a financing statement. Revised Article 9 remains silent concerning its classification of deposit accounts, but the control requirement suggests that it views the depositor's right as tangible.

B. *The Control Requirement*

1. Perfection of Deposit Accounts

A creditor can only perfect a security interest in deposit accounts by obtaining control of the account.[107] It obtains control either by extracting a control agreement from the depositary bank or by becoming a customer of the deposit account for which it seeks control.[108] Both methods of control require the assent the depositary bank maintaining the account and nothing in Revised Article 9 requires the bank to grant such assent.[109]

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[106] *See id.* § 9-310. Section 9-310 allows perfection by filing for personal property unless that provision provides an exception. *Id.* No such exception exists for intangible from which one can deduce that perfection of intangible requires a filed financing. *Id.*

[107] *See* Rev. U.C.C. § 9-104(a).

[108] *See id.* § 9-104(a)(2)-(3).

[109] *Id.*

Under both types of control, attachment is automatic[110] once the creditor has control of the deposit account assuming "value has been given"[111] and "the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party.[112] To obtain control through an agreement both the depositary bank and its depositor must assent through "an authenticated record that the bank will comply with instructions originated by the secured party directing disposition of the funds in the deposit account without further consent by the debtor."[113] The revised rules, however, clearly state a bank does not have to enter a control agreement even if its depositor so wishes.[114]

Revised Article Nine provides that a control agreement can restrict or limit the debtor's ability to withdraw from the account, but unlike common law, exclusive control is not required to have a perfected interest in deposit accounts.[115] By liberalizing the control requirement, the creditor can, if it so wishes, allow the depositor access to the account without jeopardizing its

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[110] *See generally id.* § 9-203(a)-(b) (providing the elements necessary to achieve attachment of a security interest in personal property).

[111] *See* Rev. U.C.C. § 9-203(b)(1).

[112] *See id.* § 9-203(b)(2).

[113] *See id.* § 9-104(a)(2).

[114] *See id.* § 9-342. The section states, "This Article does not require a bank to enter into an agreement of the kind described in Section 9-104(a)(2) [control agreement], *even if its customer so request or directs*. *Id.* (emphasis added).

[115] *See* Rev. U.C.C. § 9-104(b) & cmt. 3. (2001). The control agreement, however, would not prevent the bank from paying checks drawn on the depositor's account that are presented for payment. *Id.* § 9-332(b). The control agreements endorsed by Revised Article 9 departs from the common law under which courts generally rejected control agreements that did not provide creditors with exclusive control; thus liberalizing the control requirement.

perfection of it.[116] But such rules are significant only if banks assent to such agreements.

[116] *Id.* § 9-104(b) & cmt. 3.

Creditors can also obtain control by becoming a customer of the depositary bank through establishing an account in their own name or jointly with its debtor.[117] This method of control is reminiscent of reserve or lockbox accounts established by creditors to secure pledges of deposit accounts under the common law. Creditors enjoy certain advantages by establishing accounts in their name in lieu of obtaining control agreements.[118] For example, creditors can effectively block depositors' access to reserve accounts.[119] Also, establishing such accounts will likely be less costly than negotiating control agreements from depositary banks, and presumably, less burdensome than it was to establish reserve accounts under the common law.[120] Most importantly, this method of control grants creditors priority against all competing claims even those asserted by depositary banks.[121]

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[117] *Id.* § 9-104(a)(3); *see also id.* § 4-104 (providing rules related to establishing bank accounts).

[118] *See* Hillinger et al., *supra* note 9, at 31.

[119] *See id.*

[120] *Id.*; *see also* Harrell, *supra* note 10, at 71 (nothing that obtaining a pledge of a deposit account through establishing a special deposit account was costly and burdensome).

[121] Rev. U.C.C. § 9-327(c). Revised Article 9 also grants priority to a creditor asserting such control against a bank setoff's rights to such accounts. *See id.* § 9-340.

Like control agreements, nothing in Article 9 requires that banks establish such accounts on behalf of creditors, even if bank depositors so wish.[122] Most certainly banks will refuse control requests involving general operating accounts, since depositors draw on these accounts to pay general operating expenses and withdraw from these accounts within in the ordinary course of their business. Moreover, banks typically exercise setoffs against these accounts to satisfy defaulted obligations. Creditors may even find it difficult to establish special accounts in their name. Before the adoption of the revised deposit account rules, creditors experienced difficulty establishing special reserve accounts.[123] Unless strong market pressures resulting from the advent of the revised rules influence banks to establish such accounts, they will probably continue to resist such requests.

To the extent that banks refuse to establish reserve accounts, the depositor must find a willing bank that will establish a special account for the creditor. The movement toward national banking heightened by increases in mergers and acquisitions within the banking industry may provide depositors and their creditors with limited options. Arguably, the restrictive nature of the control rules has laid the groundwork for a quasi-monopolistic market where banks dominant deposit account financing while shaping constricts under which such financing can occur by non-depositary bank creditors. To the extent the control rules create such an environment, access to and the price of such financing may continue to restrict financing opportunities as it was under

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[122]Revised Article 9 does not explicitly state that banks can refuse to open such accounts. Article 4 and Federal Reserve regulations govern bank-customer relations and neither body of law compels a bank to open an account for a requesting party. A bank's decision to establish an account with a customer is a contractual issue, and most banks enter such contracts when they view them as beneficial to their financial interests.

[123]*See* Hillinger et al., *supra* note 9, at 49-50.

the common law.

2. Priority Rules

The priority rules also favor banks. Revised Article 9 grants priority in deposits to banks maintaining control of them unless a creditor obtains control by establishing a special account in its name or along with its debtor.[124] The rules also grant priority to banks exercising setoff rights in a deposit account unless the creditor has established a special account.[125] Ironically, the creditor cannot establish such an account without the cooperation of the bank which may view the creditor as its competitor.

3. Bank Response to the Control Rules

Given the ease with which banks can engage in deposit account financing, their willingness to grant control to other creditors will probably depend on whether they have extended or expect to extend credit secured by the deposit accounts they maintain. Banks use deposit account funds not only to satisfy overdraft credit extensions but also to secure loan advances and to offset debts owed by their depositors. It seems unlikely that banks will grant control to lenders if they view them as competitors. In light of the financial interests that banks have in the accounts they maintain, their willingness to grant control to other creditors is at best questionable, especially control that would subordinate their security interests.

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[124] *See* Rev. U.C.C. § 9-104(a)(3).

[125] *See id.* § 9-340(c).

The special nature of deposit accounts may render such a result desirable, especially given their role in the payment system. Revised Article 9, however, provides no discussions concerning why it appointed banks as the protectorate of the system. Nor does it address the likelihood that banks, in determining whether to grant control, will be blinded by their own financial interests to the detriment of their depositors. Revised Article 9 remains silent on these issues, while the drafters of the revised rules justify their position by underscoring the need to protect the payment system from unbridled financing by non-depositary bank creditors. Nevertheless, designating banks as the protector of the system whereby they can restrict creditor access to accounts while granting them unrestricted access is arguably akin to the "fox guarding the hen house." Begging the question, "Who's protecting the deposit account from the banks that maintain them?"