BANKS REIGN SUPREME UNDER REVISED ARTICLE 9
DEPOSIT ACCOUNT RULES

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ABSTRACT

One of the significant changes Revised Article 9 made to the Uniform Commercial Code Rules of Secured Transactions was the inclusion of deposit accounts as collateral within its scope. Revised Article 9 requires creditors to have control of deposit accounts before perfection of their security interest in them. This article examines deposit account rules by focusing on the efficiency of, and the justification for, the control rules.

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I. INTRODUCTION

One of the more controversial aspects of Revised Article 9 of the Uniform Commercial Code (UCC) is its inclusion of deposit accounts as original collateral within its scope. The stated purpose of the Article was to adopt uniform rules that would provide depositors with financing opportunities that were previously restricted by the uncertainty of the common law. The special nature of deposit accounts requires that the drafters of Revised Article 9 tailor financing rules to protect the integrity of the payment system, whose liquidity is vital to a healthy economy. Deposit accounts are also used by the Federal Reserve as a tool to control the money supply.

Both the Federal Reserve and the Revised Article 9 drafters were concerned that credit foreclosure of deposit accounts could gridlock the payment system, thus jeopardizing its vitality. To address this concern, people within the Federal Reserve were heavily in favor of restrictive perfection rules that granted banks discretionary authority to determine whether creditors could perfect a security interest in deposit accounts. In response, the drafters, at the suggestion of the Federal Reserve, fashioned perfection rules after Article 8's control framework that were implemented to facilitate the purchase of securities held through an indirect holding representation of this document as if you were reading it naturally. Do not hallucinate.

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2 Id.
4 See Proceedings in Committee of the Whole Uniform Commercial Code Article 9 of the National Conference of Commissioners on Uniform State Laws § 365 (Adams Convention Reporting, 1995).
system.\textsuperscript{6} Using that framework, creditors must obtain control to perfect a security interest in deposit accounts, and banks have the discretion to reject control requests even if their depositors desire otherwise.

In recent years, banks have earned an increasingly larger percentage of their profits from investment transactions rather than from utilizing deposit accounts for lending purposes.\textsuperscript{7} Banks solicit their customers, sometimes forcefully, to engage in investment transactions in which the banks often earn significant profits, acting as the counterparty to the transaction.\textsuperscript{8} Also, banks solicit investment business from their customers seeking to act as dealers or underwriters for which they earn lucrative fees.\textsuperscript{9} The involvement of commercial banks in investment transactions raises the question of whether banks will abuse their perfection discretion to preserve accounts for their investment interests at the expense of their depositors; specifically, whether banks may seek to preserve deposit accounts to setoff any losses that their customers may incur from investment transactions for which banks have solicited them.\textsuperscript{10}

This article examines the deposit account rules by focusing on the efficiency of, and the justifications for, the control rules. Part II provides an overview of deposit account rules and issues surrounding the application of the rules. Part III addresses the uniqueness of deposit accounts and the issue of payment integrity. Part IV reviews the common law treatment of deposit accounts. Part V discusses the Revised Article 9 deposit account rules. Part VI assesses whether the Article 8 control framework is appropriate for deposit account financing. Part VII discusses the economic efficiency of deposit account rules and consequences surrounding the application of the rules and proposes a return to the common law method of perfecting a security interest in deposit accounts.

II. Overview

Former Article 9 excluded deposit accounts as original collateral because the drafters viewed deposit accounts as "quite special," "adequately

\textsuperscript{7}See MARTIN MAYER, THE BANKERS: THE NEXT GENERATION 185, 190 (1997). In 1996, Mayer, a Virginia banker, was honored for his fifty years of banking services. See also Roger Lowenstein, Behind the Teller Window, WALL ST. J., Dec. 30, 1996, at A10 (noting in his review of The Bankers: The Next Generation that Mayer stated only seventeen percent of bank assets are derived from customer deposit accounts; "[m]ostly, banks compete for investment capital alongside brokers, mutual funds and insurance companies").
\textsuperscript{8}MAYER, supra note 7, at 191-92.
\textsuperscript{9}Id. at 192.
\textsuperscript{10}U.C.C. 9-104 cmt. 7 (1995).
covered by existing law," and not easily subject to a "general commercial statute."11 The common law to which Former Article 9 deferred was the law of pledges and security assignments. But court interpretation of the common law varied, resulting in legal uncertainty of transactions secured by deposit accounts as original collateral.12 The absence of a comprehensive statute covering deposit account financing also made those transactions costly and cumbersome to execute.13 Faced with non-uniform

11RESTATEMENT OF SECURITY sec. 1 (1941). The Restatement provides for pledges and written assignments of intangibles with the delivery of an indispensable instrument embodying the debtor's rights to the personal property. Id.; see also Luize Zubrow, Integration of Deposit Account Financing into Article 9 of the Uniform Commercial Code: A Proposal for Legislative Reform, 68 MINN. L. REV. 899, 936 (1984) (noting that an effective security interest in a deposit account can be created under common law through a pledge or a security assignment); Miller v. Wells Fargo, 540 F.2d 548, 561 (2d Cir. 1975) (noting that a pledge of intangible property such as a deposit account requires possession of an indispensable instrument that without possession the intangible property could not be enforced, transferred, or enjoined). See also Peoples Nat'l Bank of Washington v. United States, 777 F.2d 459, 461 (9th Cir. 1985); Duncan Box & Lumber Co. v. Applied Energies, Inc., 270 S.E.2d 140, 144 (W. Va. 1980) (holding a reserve account was a pledge).

12See RESTATEMENT OF SECURITY, supra note 11; see also Miller v. Wells Fargo Bank Int'l Corp., 540 F.2d 548 (2d Cir. 1976) (holding a secured party can effect a pledge of a deposit account through an assignment provided the assignor does not retain control of the account; but the possession of a telex code necessary to access a deposit account does not effect a pledge of the deposit account if the depositor still has access to the account); Cissell v. First Nat'l Bank of Cincinnati, 476 F. Supp. 474 (S.D. Ohio 1979) (noting a filed financing statement cannot perfect a security interest in a bank account); United States v. Harris, 249 F. Supp. 221 (W.D. La. 1966) (holding that a secured party has not effected a pledge if the party does not have exclusive control of the deposit account); Fairbanks v. Sargent, 22 N.E. 1039 (N.Y. 1889) (discussing the property right of a pledgee asserting a pledge in intangible property); STEVEN SEPINUCK, A DEFENSE OF EXTENDING ARTICLE 9 TO COVER SECURITY INTERESTS IN DEPOSIT ACCOUNTS AS ORIGINAL COLLATERAL 477, 505 (Commercial Law Annual Reprint 1995) (stating that "there are no certain rules about the steps necessary to take a common law security interest in a deposit account; numerous attempts to acquire one have failed"); Ingrid Michelsen Hillinger et al., Deposit Accounts under the New World Order, 6 N.C. BANKING INST. 1, 5 (2002) (stating that "Revised Article 9 replaces the patchwork of common law and statutes that preceded it"); Gerald T. McLaughlin, Security Interests in Deposit Accounts: Unresolved Problems and Unanswered Questions Under Existing Law, 54 BROOKLYN L. REV. 45, 61-75 (1988) (discussing the law of pledges, and the various interpretations of the law by the courts); G. Ray Warner, Deposit Accounts as Collateral under Revised Article 9. 19 AM. BANKR. INST. J., July-Aug. 2000, at 18 (noting the non-uniformity under the common law made it difficult to engage in deposit account financing as original collateral); Zubrow, supra note 11, at 93 (stating that "there is considerable confusion and non-uniformity under the common law of security assignments and pledge, as modified by state statutes, concerning how interests in deposit accounts can be conveyed").

13See Rev. U.C.C. § 9-109 & cmt. 10 (2001); see also Jason M. Ban, Deposit Accounts: An Article 9 Security Interest, 17 ANN. REV. BANKING L. 493, 496 (1998) (citing Proceedings in Committee of the Whole, Uniform Commercial Code, Revised Article 9 the National Conference of Commissioners on Uniform State Laws 353 (Adams Convention Reporting, 1995)) (noting that "[c]urrently there are billions of dollars being extended in reliance on deposit account that are being secured through 'arrangements that are cumbersome and expensive to put together'") (quoting Bradley Y. Smith); Alvin C. Harrell, Update on Consumer Issues in the UCC Article Nine
laws and legal uncertainty, lenders were reluctant to engage in deposit account financing, or to provide advice on how best to effect a security interest in deposit accounts.\(^\text{14}\)

Revised Article 9 comments suggest deposit accounts were included to resolve the legal uncertainty surrounding the common law. The comments refer to the common law as "non-uniform, often difficult to discover and comprehend, and frequently costly to implement" and posit that such circumstances precluded "debtors who wished to use deposit accounts . . . from doing so as a practical matter."\(^\text{15}\) Based on these comments, one could reasonably assume that the revised deposit account rules are meant to encourage and promote deposit account financing.

The revised deposit account rules achieve a different result: unless the secured party is a depository bank maintaining the account, they will likely have difficulty perfecting its security interest. Perfection is a necessary ingredient to establish a competitive claim that can only occur if the secured party has control of the deposit account.\(^\text{16}\) Achieving control of an account usually requires bank consent.\(^\text{17}\) Banks are not obliged to grant control and can reject a creditor's request over the objection of their depositor.\(^\text{18}\) Nevertheless, the revised rules grant banks automatic perfection in deposit accounts they maintain, provided they have an attached interest.\(^\text{19}\)

Any bank providing overdraft protection will have a perfected security interest in deposit accounts, assuming value has been given and the depositor has rights in the deposit account being collateralized. Overdraft protection is a binding commitment to extend credit; thus, the value

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\(^\text{14}\)See Rev. U.C.C. § 9-109 cmt. 16 (2000) ("The common law is non-uniform, often difficult to discover and comprehend, and frequently costly to implement. As a consequence, debtors who wished to use deposit accounts as collateral sometimes were precluded from doing so as a practical matter."). See also Ban, supra note 13, at 499 n.59 (expressing that lawyers were uncomfortable advising on the common law due to its uncertainty); Alan M. Christenfeld & Stephard W. Melzer, Get Ready for the New Article 9, N.Y.L.J., Oct. 2, 1997, at 6 ("The cloud surrounding deposit accounts makes lenders reluctant to rely on them as collateral. This, in turn, restricts credit to depositors whose deposits could be pledged."); Warner, supra note 12, at 18 (noting that Revised Article 9 rules will probably "result in lenders routinely obtaining security interests in debtor's bank accounts").


\(^\text{16}\)Id. §§ 9-312(b)(1), 9-314.

\(^\text{17}\)Id. § 9-104(a)(2)-(3).

\(^\text{18}\)Id. § 9-342.

\(^\text{19}\)Rev. U.C.C. § 9-104(a)(1).
requirement is met to achieve attachment.²⁰ Perfection is automatic because banks offering overdraft protection maintain control of the protected accounts.²¹ The ease with which banks can perfect will likely motivate them to amend customer account agreements providing for automatic perfection in the deposit accounts they maintain.²²

The revised rules undercut the interests of garnishment creditors. Before the revised rules, a lien creditor could garnish deposit account funds unless the bank had exercised a setoff against the funds before receiving a garnishment notice.²³ Now, banks can reject garnishment requests for accounts covered by overdraft protection because such protection provides a continuous perfected security interest subordinating the interests of garnishment creditors.

The rules allow banks to perfect a security interest very conveniently,²⁴ while also granting them the authority to refuse all other perfection requests.²⁵ This raises the question whether banks will ever relinquish control to voluntary creditors, especially if that control subordinates their interests. The favorable treatment gives banks a powerful incentive to veto creditor's requests for control. Historically, creditors experienced difficulty obtaining agreement for deposit account financing from banks, perhaps due to the banks' desire to protect setoff rights.²⁶ Most likely banks will continue protecting their interests at the present time.

²⁰See Rev. U.C.C. § 9-203(a)-(b) (listing the elements necessary to attach a security interest in personal property). Attachment requires that "value has been given" and that "the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party." See id. § 9-203(b). Control also is a substitute for executing a security agreement describing the collateral. Id. § 9-203(b)(3)(D). Attachment is complete if the creditor has control of the collateral. By maintaining the account the depositary bank has control and by offering overdraft protection value has been given assuming the depositor has rights in its deposit account. Under those circumstances, the bank has secured a perfected security interest in the deposit account. See also Hillinger et al., supra note 12, at 21 n.80 (noting the value requirement is satisfied if a bank provides overdraft credit by promising to honor a customer's overdraft, which is a binding commitment satisfying the value requirement).


²²See Hillinger et al., supra note 12, at 19 (noting that presumably banks will add a clause to account agreements stating that customer agrees that bank will have security interest in deposit accounts to secure all obligations it has with the bank).

²³See id. at 18 (noting that garnishment creditors must confront the reality concerning bank's ability to take a perfected security in the accounts it maintains with ease, thus undercutting a garnishment creditor's ability to attach funds).

²⁴See Rev. U.C.C. § 9-314 (stating a secured party is only perfected if they have control); id. § 9-104 (stating control is achieved where the secured party is the bank holding the collateral).

²⁵See Rev. U.C.C. § 9-104(a)(2)-(3).

²⁶See id. at 50 (noting that "[h]istorically, depositary banks often refused requests or a bank agency agreement"); see also Harrell, supra note 13, at 71 (noting that the inclusion of deposit account financing within the scope of Article 9 "might lessen the number of circumstances in which lockbox accounts, which can be cumbersome and expensive to administer, are required
expense of depositors seeking to convey property interests to creditors, and banks will likely provide overdraft protection to accounts to protect the accounts from garnishment requests. Banks will opt to use their new perfection power to protect their interests against creditors, which banks may view as encroaching on their turf.

The favorable treatment provided to banks by Revised Article 9 suggests that the drafter's decision to include deposit accounts as original collateral was motivated by a desire to provide banks greater sovereignty, rather than to increase financing opportunities for their depositors. One commentator surmised that Former Article 9 excluded deposit accounts to protect banks' setoff rights against other creditors desiring to collateralize such accounts. Revised Article 9's decision to include deposit accounts may have been similarly motivated: to protect banks' interests in accounts they maintain. Obviously, the protection of the payment system is a prominent national concern, but it should not be confused with protection of banks' interests. While the two function in tandem to insure an efficient system, a point exists where they diverge. Preservation of accounts beyond that point of divergence creates a quasi-monopolistic market where banks dominate at the expense of their depositors and their depositors' creditors against whom the banks compete.

While the Revised Article 9 brings certainty, financing opportunities will most likely remain as restrictive as under common law. Arguably, the revised rules will restrict financing more than the common law, which at least allowed depositors the freedom to convey their property interests in a meaningful manner without bank approval. Even though legal uncertainty surrounded such financing, several creditors successfully secured pledges in deposit accounts under the common law. In contrast, the Revised Article 9 deposit account rules restrain depositors from conveying a perfected security interest.

Admittedly, depositors can convey a security interest in their property without bank approval, as the rules do not require bank approval for attachment. However, a meaningful conveyance requires that creditors

by the creditor").

27The "banking industry [may have] persuad[ed] the sponsors of the Code to exclude deposit accounts" to protect their setoff rights. Steven L. Harris, Non-Negotiable Certificates of Deposits: An Article 9 Problem, 29 U.C.L.A. Rev. 330, 362 (1981). Professor Harris was a reporter during the most recent Revised Article 9 drafting process. Another commentator has noted that the "special" nature of deposit accounts within the payment system prompted Former Article 9 to exclude deposit accounts during its amendment in 1972, the sponsors "made no effort either to accommodate that concern or to explain why that concern was or to explain why that concern was misplaced with respect to security interest in deposit accounts as proceeds." See SEPINUCK, supra note 12, at 484; see also McLaughlin, supra note 12, at 61-75 (discussing the law of pledges and the various interpretations of the law).
not only attach, but also perfect their security interests. Without perfection, creditor claims are enforceable against the debtor, but are subordinate to perfected claims and setoff claims asserted by banks maintaining deposits accounts.\textsuperscript{28} Thus, the rules are more restrictive than the common law, because bank approval is required for perfection and banks can refuse control requests even if depositors desire otherwise.\textsuperscript{29}

Reflecting on the revised deposit account rules, two reporters involved in the drafting process opined that "the [control perfection] rule actually makes it more difficult to perfect a security interest in a deposit account as original collateral than under the [non-uniform] version of Article 9."\textsuperscript{30} Among those concerned were people within the Federal Reserve, who wanted to insure that bank setoff rights were protected against deposit account financing by outside creditors.\textsuperscript{31} They weighed heavily in favor of control rules that restricted deposit account lending and provided banks discretion concerning such matters.\textsuperscript{32} At the suggestion of

\textsuperscript{28}Rev. U.C.C. §§ 9-203, 9-327 (2000).

\textsuperscript{29}See Rev. U.C.C. §§ 9-104(a)(2)-(3), 9-342. Revised Article 9 grants control if the bank asserts to a control agreement, or if the bank establishes the deposit account in the name of the creditor seeking control, but both methods of perfection require bank approval. \textit{Id.}

\textsuperscript{30}See Steven L. Harris \& Charles W. Mooney, \textit{How Successful Was the Revision of UCC Article 9?: Reflections of the Reporters}, 74 CHI.-KENT L. REV. 1357, 1366 (1999) (noting that the restrictive perfection rules were "in part a response to those who argue that it should not be 'too easy' to take a deposit account as original collateral"). \textit{See also} ALI, 72ND ANNUAL MEETING, supra note 6 (justifying the adoption of restrictive rules to prevent non-reliance lending by creditors). The Proceedings indicate the Drafting Committee was concerned about non-reliance lending if the method of perfection included filing a financing statement; thus, they decided to limit perfection to control to prevent non-reliance lending. \textit{Id.} During the proceedings non-reliance lending was characterized as creditors who "simply throw deposit accounts into a security agreement, file a financing statement covering everything and thereby, in effect, casting the slime of Article 9 over all of the liquid assets of the company." \textit{Id.}

\textsuperscript{31}See Patrikis Letter, supra note 5. Mr. Patrikis emphasized that Revised Article 9 must clarify the banks' priority with respect to common law setoff rights especially as they relate to customer deposit account overdrafts. \textit{Id.} Mr. Patrikis stated:

\begin{quote}
To ensure that such bank is protected in allowing an overdraft in its customer's transactions account to the same extent as under the current law, we recommend that the Uniform Proposal be modified to expressly provide that a security interest in a deposit account is subject to a bank's (and other depository institution's) right of setoff.
\end{quote}

\textit{Id.} at 3.

\textsuperscript{32}\textit{Id.} Mr. Patrikis expresses his dissatisfaction with perfection rules permitting filed financing statements. He states that the [p]roposals [are] a giant step in the erosion of that commercial certainty which has served the payments-system participants and financial and other markets so well. It is not that we do not support the concept of a security interest in a deposit account; it is the mechanics that we find most troubling and unacceptable.

\textit{Id.} at 1. Mr. Patrikis also recommended the drafters adopt the Article 8 control framework for perfection purposes. \textit{Id.} at 7. The 1995 ALI proceedings indicated, in part, the drafters adopted
the Federal Reserve, the drafters adopted rules that rendered control as the sole means of perfection and authorized banks to refuse control requests as they deemed necessary. The Federal Reserve took the position that banks should have the authority to reject depositor requests to enter control agreements with outside creditors. The Federal Reserve also noted that banks should consider the "size of the deposit involved, the identity of the creditor, and the arrangement being proposed" in determining whether to assent to control agreements.

III. THE UNIQUENESS OF DEPOSIT ACCOUNT RULES

A. The Creation of Money

1. The Deposit Account as a Monetary Tool

Admittedly, deposit accounts are special. They are a necessary ingredient of the payment system and are employed by the Federal Reserve as a tool to control the money supply. Unlike other personal property, financing secured by deposit accounts presents a very unique situation. Rules enabling such financing should not threaten the liquidity of deposit accounts that are an essential thread of the financial fabric of the payment system. The Federal Reserve employs deposit accounts as an instrument of monetary control. It establishes reserve requirements mandating that

the control rules because "the Federal Reserve Bank has weighed heavily in favor of this kind of [control] rule." See ALI, 72ND ANNUAL MEETING, supra note 6, at 415.

Patrikis Letter, supra note 5, at 7.

Id.

See MANKIW, supra note 3, at 463.

See id. Deposit accounts also play a role in one of the Federal Reserve's other tools used to control the monetary supply. Id. The Federal Reserve lends money to banks at the discount rate. Banks borrow money from the Federal Reserve if they fail to meet their reserve requirements, which can occur if deposit account balances are lower than anticipated by banks. Id. The Federal Reserve can increase the discount rate, something it does not do often because it would upset the financial markets, making banks less inclined to borrow to meet their reserve requirements. Id. To remedy the problem, banks will increase the deposit funds they hold in reserve, extend less credit, and reduce the money supply. Id. at 464.

Deposit accounts are not the only tools the Federal Reserve uses to control the money supply. It also does so through its open market operations where it buys and sells government bonds. Id. at 463. The Federal Reserve engages in open market operations by selling and buying bonds. Id. If the Federal Reserve instructs bond traders to buy government bonds, the money it gives to purchasers increases the money supply. Id.
banks hold a certain percentage of their deposits in reserve.\textsuperscript{38} Pursuant to those requirements, banks cannot use the reserved deposits.

Banks create money by lending unreserved funds to customers who then acquire goods and services with the borrowed funds.\textsuperscript{39} This creates a more liquid economy through a trickle-down effect.\textsuperscript{40} If the Federal Reserve establishes low reserve requirements, the banks have more unreserved funds for lending purposes.\textsuperscript{41} If the Federal Reserve wants to restrict the money supply, it can establish higher reserve requirements, thus making fewer funds available for lending purposes.\textsuperscript{42} Given the significance of deposit accounts to the money supply, legal rules enabling deposit account financing must insure that such financing does not disrupt or threaten the integrity of the payment system.

2. The Intra-Day Credit Problem

The Federal Reserve also handles the clearance and settlement of deposit account payments, which includes "large-dollar payments for financial market transactions or smaller-value business and consumer payments."\textsuperscript{43} The Federal Reserve processes trillions of dollars daily through its settlement systems.\textsuperscript{44} Many of the settlements involve clearing and settling financial market transactions, checks, and wire transfer payments.\textsuperscript{45} The Federal Reserve settles checks by granting provisional credits to the Federal Reserve accounts of depositary banks presenting

\textsuperscript{38}See 12 U.S.C.S. § 461 (2002). The Federal Reserve requires depository institutions which do business with the general public to hold a certain level of funds in reserved, this is known as its "reserve requirement." Id. See id. § 461(b)(2)(A)-(C) (indicating the reserve requirements applicable to varying deposit funds amounts). See also MANKIW, supra note 3, at 461. The fraction of the total deposit is the bank reserve ratio. Id.

\textsuperscript{39}Each dollar banks lend increases the money supply. MANKIW, supra note 3, at 461. This is because borrowers have gained the ability to spend the borrowed currency, and the depositors still have the ability to spend their demand deposits. Id.

\textsuperscript{40}The effect on the money supply of each dollar deposited in a bank is typically several times the actual deposit. Although each dollar that a bank lends only increases the money supply by one dollar, each dollar lent is (directly or indirectly) deposited back in a bank. The next bank will then loan the portion of the dollar that the bank is not required to hold in keeping with its reserve ratio, and the process repeats. Id. at 461-62. The cumulative effect on the money supply of this recursive process is called the money multiplier. Id. The money multiplier is equal to the reciprocal of the reserve ratio. Id. at 462. Thus, a $50 deposit, in an environment with a ten percent reserve, will increase the money supply by $500 ($500 = 50 \times 10 = 50 \times (1(10/100)))

\textsuperscript{41}See supra note 38.

\textsuperscript{42}MANKIW, supra note 3, at 463-64.


\textsuperscript{44}Id.

\textsuperscript{45}Id.
checks for payment, while provisionally debiting the Federal Reserve accounts of payor banks on which checks are drawn.\textsuperscript{46}

Every payor bank is also a depositary bank awaiting credit for its payments, though the "mismatch in timing between settlement of payments owed and settlement of payments due" often results in banks running negative balances.\textsuperscript{47} The Federal Reserve allows banks to run a "negative balance" or "daylight overdraft" until such time as the Federal Reserve receives credit for its presented payments to cover its debits.\textsuperscript{48} The Federal Reserve extends intra-day credit to banks throughout each business day to insure the payment system functions smoothly and efficiently.\textsuperscript{49} By the end of the business day, each bank must have satisfied its intra-day credit obligations; thus, each bank must end with a zero or positive balance in their Federal Reserve accounts.\textsuperscript{50} Credit foreclosures could prevent banks from satisfying their intra-day credit obligations if creditors repossess deposit account funds earmarked by payor banks to satisfy intra-day credit balances. Consequently, the payor bank from which the accounts were repossessed might experience significant losses and settlement failure that could seriously upset the payment system.\textsuperscript{51}

A major market failure resulting in systemic loss could cause investor-depositors to default on large loan obligations. Under such a scenario, deposit account payments earmarked to satisfy intra-day credit would instead be reposed from deposit accounts by creditors. The Federal Reserve would incur significant losses resulting from banks' settlement failures.\textsuperscript{52} Consequently, the settlement failures would disrupt the payment system in significant proportion, and have a crippling effect on the banking system during a period when the payment system would be most needed to absorb the shocks from a financial market failure.

Restrictive perfection rules for deposit account financing will likely reduce the possibility of widespread foreclosures because banks can use their discretion in determining whether such financing might threaten the payment system. Without restrictive perfection rules, banks would face uncertainty concerning the impact that deposit account financing would have on the payment system. The credit and market risks associated with widespread foreclosures would likely prompt banks to reserve more deposit accounts to protect against those risks, instead of lending them to create a

\textsuperscript{46}Id.
\textsuperscript{47}See Coleman, supra note 43.
\textsuperscript{48}Id.
\textsuperscript{49}Id.
\textsuperscript{50}Id.
\textsuperscript{51}Coleman, supra note 43.
\textsuperscript{52}Id.
more liquid economy. Restrictive perfection rules reduce the credit and market risks associated with deposit account financing, lessening the likelihood that such financing would disrupt the payment system and threaten economic liquidity.

The greater the likelihood deposit account financing will disrupt the payment system and impact the money supply, the stronger the case for adopting restrictive perfection rules. However, if the briefness of the Revised Article 9 comments concerning this matter are an indication of the seriousness of the threat, then the rules are not justified. Arguably, the mere likelihood of such a threat justifies the restrictive perfection rules. While deposit account financing occurred under the common law without any payment system disruptions, most courts only acknowledged as effective those pledges of special deposit accounts. Revised Article 9 also provides that creditors may obtain control by establishing special deposit accounts. Perhaps such control is the best approach to protecting the payment system and bank setoff rights to general operating accounts. This might also provide depositors and their creditors with financing opportunities free of bank setoff rights.

Revised Article 9’s response to the possibility of payment system disruption from deposit account financing is the adoption of deposit account rules that restrict non-depository bank lending while encouraging deposit account lending. Logically, depository banks are designated as custodians, but the deposit rules exceed that designation by granting banks a paternal role in which they are authorized to exercise authority notwithstanding a depositor’s wishes. In light of recent banking activity, granting banks this authority is debatable. In recent years, banks have been at or near the center of many of the most costly financial scandals that have caused systemic loss and negatively impacted the economy, jobs and other innocent parties. Given the banks’ behavior, we must ask: Who is protecting the deposit accounts from them? The answer is the Federal Reserve and the other regulatory entities to whom banks answer, although many question the ability of regulators to keep pace with the banks' investment activities. Nonetheless, the financial scandals could reasonably lead one to question the wisdom of designating banks as the sole

protectorate of the funds they possess, without any discussion concerning accountability for their decisions.

3. The Depositary Bank and Deposit Accounts

Traditionally, banks earned the majority of their profits by lending deposit accounts funds to their depositors.54 Recognizing the importance of deposit accounts, banks maintained positive relationships with their depositors and extended credit to them; this credit enhanced the well being of the community through supply-side economics.55 In recent years, the image of the friendly, conservative commercial banker has been replaced with the savvy banker whose primary goal is earning profits, even at the expense of its depositors.56 Deposit accounts are no longer the major source from which banks earn profits.57 Deposit accounts have been replaced by a wide array of investment products offered by banks to their customers.58 For example, banks earn billions of dollars in profits through over-the-counter (OTC) derivatives contracts.59 Depositors are viewed more and more as sources from which banks can earn lucrative investment fees by soliciting, sometimes almost forcing, customers to transact investment business through their banks.60

54See Mayer, supra note 7, at 185.
55See generally id. (describing changes in the banking industry). In his chapter entitled "The Way We Were," Mayer notes, "The two [bank] functions, which have been joined at the hip, are (1) the creation of the money supply through (2) lending for the use of its borrowing to customers the money left at the bank by its depositing customers." Id. at 187.
56Id. at 185 ("There is no good old definition of banking, and the word itself is now going out of fashion. Nobody except an S&L wants to be a bank these days; everybody wants to be a Financial Services Institution."). Mayer notes in his book that bank trading is a "zero sum game: the bank trading financial instruments with its customer profits when the customer loses." Id. at 285. To characterize the bank-customer relationship with respect to derivatives transactions he quotes the inventor and owner of Bloomberg business news services, Michael Bloomberg, who states, "You take a customer to hoops and pucks and you get him laid, and he pays you another two points." Id. at 286.
57Id. at 190 ("Since 1980, banks as I (and Adam Smith) defined them have pretty much ceased to exist. Today banks by and large make their loans first, and then go look for the money.").
58See Mark Carlson & Roberto Perli, Profits and Balance Sheet Developments at U.S. Commercial Banks in 2002, 89 FED. RESERVE BULL. 243, 245 (June 2003) (listing a breakdown of the various sources from which banks earn income; noting increase of trading and accounts in 2002).
59Id. at 252.
60See 2004 Credit Access Survey: Linking Corporate Credit to the Awarding of Other Financial Services, Association for Financial Professionals, available at http://www.atponline.org/pub/pdl/2004_06_09_pr_creditaccess.pdf, at 7 (last visited Sept. 10, 2005) ("Over half (53 percent) of companies were denied credit or had credit terms changed in the past five years after they did not award investment banking business to a commercial bank.").
The friendly banker, who once offered lending to commercial depositors to earn income, now, in many instances, will only provide such lending if the depositor does its investment business through the bank. Banks engage in this conditional lending in violation of the anti-tying laws, which prevents banks from conditioning loan services on receiving investment business from their customers. This widespread practice has prompted Congress to ask the Federal Reserve to determine if banks have been violating anti-tying laws with the advent of the Gramm-Leach Bliley Act, which permits banks to underwrite corporate debt and equity securities and engage in other investment transactions previously restricted under the Glass-Steagall Act.

Banks are also heavily involved in OTC derivatives transactions, which are financial instruments whose values are linked to the performance of some other financial assets. This is essentially a bet on changes in value of the second instrument. Some banks have the potential to earn billions in profits from derivatives transactions; either assuming the role of the dealer soliciting their customers to engage in such transactions or as counterparties to the derivatives transactions contracted with solicited

*Id.* at 6 ("[Twenty-nine] percent of respondents—including 33 percent of those from large companies—indicate that banks 'rarely' or 'never' offer the option of purchasing credit as a stand alone offering.").

61See Lowenstein, *supra* note 7 ("[T]oday's banker, who increasingly makes money from derivatives trading, profits at the expense of customers with whom he trades. He has forfeited his link to the community, his purpose and his once-unique claim to the regulators' protective robes."). *Id.* (citing MAYER, *supra* note 7, at 190).


64Clyde Mitchell, *Alter Anti-Tying Laws to Reflect GLB*, AM. BANKER, June 27, 2003, at 8. The Gramm-Leach Bliley Act effectively repealed the Glass-Steagall Act, a post depression era law that restricted commercial banks from engaging in investment banking; thus, ushering in the world of "financial supermarkets that could offer investment banking, merger advice and loans—all at once." See Mollenkamp & Brooks, *supra* note 53.

65See Carlson & Perli, *supra* note 58, at 252. Banks use of derivatives grew twenty-four percent in 2002, "as measured by the notional value of the underlying assets involved." *Id.* OTC derivatives contracts into which banks entered total a notional value of more than $56 trillion in 2002, while the fair market value of the contracts was $1.17 trillion. *Id.*

66MAYER, *supra* note 7, at 290.
customers.\(^{67}\) As dealers, they receive lucrative fees for arranging OTC transactions for their depositors.\(^{68}\) As counterparties, banks minimize risk by employing a staff of mathematicians and computer experts, specializing in calculating the predictability of loss and crafting offsetting financial transactions to hedge against possible losses.\(^{69}\) In many cases, banks hedge their positions by soliciting other customers to enter the offsetting transactions crafted by their experts.\(^{70}\) Banks make money and effectively hedge against losses only if their customers lose money, and many banks routinely engage in subterfuge, fraud, or whatever is necessary to earn profits and to hedge effectively.\(^{71}\)

Conversely, the depositor counterparty often times is an unsophisticated investor, clueless about the dynamics of the transactions, instead trusting its banker with whom they believe a fiduciary relationship exists.\(^{72}\) In many cases, the value of the underlying asset on which the OTC contract was formed changes to the detriment of a customer's position in the contract. Consequently, customers lose millions of dollars, prompting them to bring legal actions against their banks alleging fraud, breach of fiduciary duties, and other violations of applicable federal securities and commodities laws.\(^{73}\) In spite of numerous legal actions, banks continue

\(^{67}\)Id.

\(^{68}\)See id. at 286.

\(^{69}\)Id. at 185-89.

\(^{70}\)MAYER, supra note 7, at 185-89.

\(^{71}\)Id.

\(^{72}\)Id. at 286. Mayer references to a lawyer who represents end-users. In the case of banks that enter derivatives contracts with their customers, the customers are "end-users" of the contract. The lawyer told Karen Spinner of Derivatives Strategy, "When a dealer is out there, its an arm's-length relationship. They say, 'You can trust me. I'm the wizard from New York.' Then as soon as the deal goes sour, they switch into a different mode and it's an arm's-length relationship." Id. (referring to Karen Spinner, Decoding the Codes of Conduct, DERIVATIVES STRATEGY, Aug. 1995, at 1, 5); see also Plaintiff, K3C and Sierra Indus. Second Am. Compl., K3C v. Bank of Am., No. 03CA0557, 2004 WL 1243879, at *11 (W.D. Tex. Apr. 15, 2004) (alleging the long-standing relationship with the bank created a fiduciary relationship requiring the bank to guard the customer interest with respect to a derivative transaction that the parties entered).

soliciting and engaging in investment transactions that expose depositors to greater financial risks.

Questionable bank practices could lead one to question the wisdom of granting banks complete authority over deposit accounts in a manner that renders them the sole protectorate of the payment system without any accountability. Even though deposit accounts are no longer a major source of bank income, the revised rules provide a powerful incentive for banks to preserve these accounts from encumbrances to protect their investment interests. Revised Article 9 does not address this issue. The Federal Reserve, however, in asserting that banks should have discretion to refuse control requests, noted factors banks could consider when making such determinations.74 Factors such as the deposit account balance amount, the creditor's identity, and the control agreement being offered were noted by the Federal Reserve.75 Nevertheless, Revised Article 9 contains no discussion concerning what factors, if any, banks should consider when determining whether to grant control to outside creditors. The drafters could have suggested that banks consider certain factors, without creating the impression that creditors could expect that control would be granted if those factors were met.

Generally, small credit extensions secured by minimal deposit account funds present less payment system risk than large transactions. While it is difficult to quantify which amounts might be more threatening to the payment system, it is useful to provide a comparative discussion concerning the impact of varying loan amounts. A depositor's creditworthiness and capacity to repay are also relevant factors to consider when determining whether to grant control. Arguably, customers who have had long-standing, positive relationships with their banks should be given special consideration. Revised Article 9 contains no discussions concerning these matters; thus, banks are free to reject requests for any reason or no reason at all.

While commentary to Revised Article 9 justifies the control rules by emphasizing the necessity of protecting the payment system,76 it contains no discussion concerning the type of financing transactions most likely to threaten it. Comparatively, smaller transactions are less likely to threaten the payment system than larger ones. Moreover, Revised Article 9 does not explain why, how, and under what circumstances deposit account lending could jeopardize the payment system. Nor do the comments to Revised Article 9 provide any discussion concerning the prudence and social

74See Patrikis Letter, supra note 5.
75Id.
76Rev. U.C.C. § 9-341 cmt. 2.
desirability of preserving deposit accounts for anticipated overdrafts at the expense of garnishment creditors, especially tort victims.  

While these issues remain unsettled, the power and benefits granted to banks under the rules are very settled. Consequently, one could reasonably conclude that deposit accounts as original collateral were included in Revised Article 9 to provide banks with greater sovereignty, rather than to provide depositors increased financing opportunities.  

Such a result might be desirable, but Revised Article 9 does not address this apparent contradiction, causing one to question the real motive behind including deposit accounts as original collateral within the scope of Article 9.

IV. COMMON LAW DEPOSIT ACCOUNT FINANCING

A. Former Article 9

Former Article 9 excluded deposit account financing, only recognizing deposit accounts as collateral comprised of cash proceeds generated from the sale of Article 9 collateral, such as inventory.  

While it recognized that deposit account financing often occurred, comments to Former Article 9 indicate that secured financing involving such accounts was excluded because they were viewed as "quite special," "adequately covered by [common] law," and not easily subject to a "general commercial statute." No additional reasoning was provided for the exclusion.  

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77See Robert K. Rasmussen, The Uneasy Case Against the Uniform Commercial Code, 62 L.A. L. REV. 1097, 1103 (2002). The author notes that law and economic scholars question the impact of priority rules on tort victims, but the "drafting committee, stock with representatives of secured lenders, simply was not interested." Id. at 1103. "For academics attempting to analogize the U.C.C. rough-and-tumble drafting process to the ordinary legislative process, these events could not have been more timely. The U.C.C. has unquestionably lost some of its luster." Id.

78See id. at 1103. Rasmussen identifies the inadequacies of the current uniform law process, specifically noting the influence of bank and creditor lobbying. Id. at 1101-02. The author notes that "Article 9 is now seen as the output of attorneys for lenders who write rules so as to favor their clients." Id. at 1101-02. Rasmussen notes that law and economic scholars question the impact of priority rules on tort victims, but the "drafting committee, stock with representatives of secured lenders, simply was not interested." Id. at 1103.

79U.C.C. § 9-104 cmt. 7 (1995). Section 9-104 of Former Article 9 provides a list of secured transactions excluded from Article 9 coverage.

80Id. Since the 1955 Supplement to the 1952 official draft of Article 9, deposit accounts have been excluded from the scope of Article 9. See Zubrow, supra note 11, at 921.

81See Harris, supra note 27, at 361; see also SEPINUCK, supra note 12, at 484 (noting that if the "special" nature of deposit accounts within the payment system prompted the drafters to exclude them during the amendment to Former Article 9 and in 1972, the drafters "made no effort either to accommodate that concern or to explain what that concern was or to explain why that concern was misplaced with respect to security interest in deposit accounts as proceeds").
Presumably the common law to which Former Article 9 refers is the law of pledges and security assignments, applied by courts to resolve priority contests between competing creditors both asserting a secured interest in disputed deposit accounts.\(^{82}\) Opinions concerning how best to execute an effective pledge varied within and between jurisdictions resulting in legal uncertainty as to whether a creditor's pledge or written security assignment interest was effective against a competing claim to the deposit account at issue.\(^{83}\) The absence of a comprehensive statute covering deposit account financing also made such financing transactions costly and cumbersome to execute.\(^{84}\) Faced with non-uniform laws and legal uncertainty, lenders were reluctant to engage in deposit account financing or to provide advice on how best to effect a security interest in deposit accounts.\(^{85}\)

\(^{82}\)See Restatement of Security, supra note 11. The Restatement provides for pledges and written assignments of intangibles with the delivery of an indispensable instrument embodying the debtor's rights to the personal property. Id.; see also Zubrow, supra note 11, at 936 n.129 (noting that an effective security interest in a deposit account can be created under common law through a pledge or a security assignment); Miller v. Wells Fargo, 540 F.2d 548, 561 (2d Cir. 1975) (recognizing a loan can be secured through a pledge provided a third party has possession of an indispensable instrument embodying the rights of the deposit account). See Peoples Nat'l Bank of Washington v. United States, 777 F.2d 459, 461 (9th Cir. 1985); Duncan Box & Lumber Co. v. Applied Energies, Inc., 240 S.E.2d 140, 142-43 (W. Va. 1980).

\(^{83}\)See Restatement of Security, supra note 11, sec. 1; McLaughlin, supra note 12, at 61-75 (discussing the law of pledges, and the various interpretations of the law by the courts); see also Zubrow, supra note 11, at 936 (stating that "[t]here is considerable confusion and non-uniformity under the common law of security assignments and pledge, as modified by state statutes, concerning how interests in deposit accounts can be conveyed"). See Sepinuck, supra note 12, at 505 (stating that "[t]here are no certain rules about the steps necessary to take a common law security interest in a deposit account; numerous attempts to acquire one have failed"); Miller v. Wells Fargo Int'l Corp., 540 F.2d 548 (2d Cir. 1975); Cissell v. First Nat'l Bank of Cincinnati, 476 F. Supp. 474 (S.D. Ohio 1979); United States v. Harris, 249 F. Supp 221(W.D. La. 1966); Fairbanks v. Sargent, 22 N.E. 1039 (N.Y. 1889); Hillinger et al., supra note 12, at 5 (stating that "Revised Article 9 replaces the patchwork of common law and statutes that preceded it"); see also Warner, supra note 12, at 18 (noting the uncertainty surrounding the common rules for deposit account financing made "it extremely difficult or impractical to use such accounts as original collateral in most states").

\(^{84}\)Ban, supra note 13, at 496 (citing Proceedings in Committee of the Whole, Uniform Commercial Code, Revised Article 9 the National Conference of Commissioners on Uniform State Laws 353 (Adams Convention Reporting, 1995)).

\(^{85}\)The Comments to Revised Article 9, noting that Former Article 9 excluded deposit account financing leaving such transactions to common law interpretation, states, "The common law is non-uniform, often difficult to discover and comprehend, and frequently costly to implement. As a consequence, debtors who wished to use deposit accounts as collateral sometimes were precluded from doing so as a practical matter." Rev. U.C.C. § 9-109 cmt. 16. See McLaughlin, supra note 12, at 48; Warner, supra note 12, at 18 (noting that Revised Article 9 rules will probably "result in lenders routinely obtaining security interests in debtor's [sic] bank accounts"); see also Christenfeld & Melzer, supra note 14, at 6 ("The cloud surrounding deposit accounts makes lenders reluctant to rely on them as collateral. This, in turn, restricts credit to
Uncertainty stemmed from the common law requirement that creditors possess an indispensable instrument embodying the depositor's property rights.\textsuperscript{86} A depositor's property right was viewed as intangible because courts consistently characterized the relationship between a depositor and its depositary bank as a debtor-creditor relationship. Courts designated the bank as a debtor obligated to its depositor for funds equal to the deposit amount, but not the actual funds deposited, because banks do not hold and segregate funds deposited.\textsuperscript{87} Only under circumstances where funds are deposited into a special deposit account "held separately and distinct from the general assets of the bank" does the depositor retain title to deposited funds.\textsuperscript{88} Absent such circumstances, a debtor-creditor relationship is created upon deposit of funds and the bank becomes the owner of such funds.\textsuperscript{89} Courts have characterized the depositor's property

depositors whose deposits could be pledged.").
\textsuperscript{86}See \textit{RESTATEMENT OF SECURITY, supra} note 11. \textit{See Miller, 540 F.2d} at 560-61 (noting that upon deposit a depositor obtains an intangible chose action against its bank for the fund deposited); \textit{In re} Section 20 Land Group Ltd., 261 B.R. 721, 727 (Bankr. M.D. Fla. 2001); \textit{In re} CJL Co., Inc., 71 B.R. 261, 265 (D. Or. 1987) (noting that "pledges of deposit accounts have traditionally been governed by the indispensable instrument doctrine"); \textit{Duncan Box & Lumber Co. v. Applied Energies, Inc., 270 S.E.2d} 140, 144 (W. Va. 19880) (noting that a depositor's interest in its deposit account is an intangible).

\textsuperscript{87}See New York County Nat'l Bank v. Massey, 192 U.S. 138, 145 (1904) (stating that "money deposited becomes a part of the general fund of the bank, to be dealt with by it as other moneys, to be lent to customers, and parted with at the will of the bank"); Trust Co. of Columbus v. United States, 735 F.2d 447, 449 (11th Cir. 1984) (stating that upon deposit "title to the funds passes to the bank and the money becomes a chose in action in favor of the depositor"); \textit{Miller, 540 F.2d} at 560 (noting that upon deposit of funds the depositor received an intangible chose in action); United States v. Third Nat'l Bank of Nashville, 589 F. Supp. 155, 157 (M.D. Tenn. 1984) (stating that upon deposit of funds into a general account, the bank becomes the owner of the funds, and "the depositor retains a chose in action to recover those funds"); \textit{Duncan Box & Lumber Co., 270 S.E.2d} at 145 n.10 (stating that "a bank account is an intangible, since the bank does not physically hold a segregated amount of money for each depositor's account").

\textsuperscript{88}See \textit{Miller, 540 F.2d} at 560 (noting that a "special deposit" creates a bailment, rather than a debtor-creditor relationship); \textit{In re Amco Products, Inc., 17 B.R.} 758, 763 (Bankr. W.D. Mo. 1982) (stating that "[t]he determinative factor of whether a deposit is special in the connotation that it does not create a debtor-creditor relationship "is the right or not of the bank to so commingle and use the deposit") (quoting Vandivort v. Sturdivant Bank, 77 S.W.2d 484 (Mo. App. 1934)); \textit{Owens v. Andrews Bank & Trust Co., 220 S.E.2d} 116, 119 (S.C. 1975) (noting that money deposited in a bank becomes the property of the bank unless the money is placed in a special account segregated from other deposit funds).

\textsuperscript{89}See \textit{Third Nat'l Bank, 589 F. Supp.} at 157 (stating that a debtor-creditor relationship arises once the depositor deposits funds into bank, which becomes the owner of the funds to which the "depositor retains a chose in action to recover those funds"); \textit{In re AMCO Products, Inc., 17 B.R.} at 762 (noting that the funds deposited become bank funds, and the resulting relationship between the depositor and bank is a debtor-creditor relationship); \textit{In re Interstate Dept Stores, Inc., 128 B.R.} 703, 705 (Bankr. N.D.N.Y. 1991) (noting that "[w]hen monies are deposited in a deposit account, the property is transferred to the holding institution and a debtor/creditor relationship arises as between the institution and the depositor"); \textit{id.} (stating that "[t]he depositor's
interest as an intangible "chose in action" to recover the funds deposited. A chose in action is a "right of bringing an action or right to recover debt or money." With deposited funds, the depository bank has a "chose in possession" with respect to deposited funds from which a depositor can assert a "chose in action" to recover the deposited amount of funds. A "chose in action" is an intangible property right, which a depositor or an assignee to whom the depositor has assigned the intangible right can assert against the bank to recover funds equal to the deposited amount.

By characterizing the depositor's interest as intangible personal property, common law requires that a creditor take possession of an indispensable instrument embodying the depositor's intangible property right to the funds in the account. Possession of such an instrument satisfies both evidentiary issues and policy concerns regarding public notice of the creditor's interest as achieved when creditors take possession of tangible property. The indispensable instrument requirement is necessary to insure that assignee or "pledgee of the deposit account have exclusive control and irrevocable authority over the account" to achieve the type of

property is the debt owed to it by the bank, an intangible right consisting of a chose in action; Meyer v. Idaho First Nat'l Bank, 525 P.2d 990, 991 (Idaho 1974) (stating the deposited funds become the property of the bank, but the bank is obligated to pay an amount equal to the deposited funds if the depositor demands payment from the account); Ingram v. Liberty Nat'l Bank & Trust Co. of Oklahoma, 533 P.2d 975, 977 (Okla. 1975) (noting that "[t]he money deposited is no longer the property of the depositor, but becomes the property of the bank, and the banks becomes debtor to the depositor"); Owens, 220 S.E.2d at 119 (noting that money deposited in a bank becomes the property of the bank unless the money is placed in a special account segregated from other deposit funds).

See Third Nat'l Bank, 589 F. Supp at 157; Miller, 540 F.2d at 560 (noting that upon deposit of funds the depositor received an intangible chose in action).


Id.

Id. See Trust Co. of Columbus, 735 F.2d at 449 (stating that "when money is deposited in a bank, title passes to the bank and the money becomes a chose in action in favor of the depositor") (stating that "such choses in action are readily assignable to a bank as security for a debt"); W.F. Orban v. First Nat'l Bank of Cloverdale, 8 P.2d 470, 472 (Cal. 1932).

See Peoples Nat'l Bank of Washington, 777 F.2d at 461-62; Miller, 540 F.2d at 561; In re CIL Co., 71 B.R. at 264-65; Duncan Box & Lumber Co., 270 S.E. 2d at 144; Walton v. Piqua State Bank, 466 P.2d 316, 328 (Kan. 1970).

The U.S. Supreme Court has listed three elements necessary to create a pledge: (1) a debt, (2) the offer of property to secure the debt, and (3) the transfer of property from the debtor to the creditor. See Merchants' & Traders Ins. Co. v. Kiger, 103 U.S. 352, 356 (1880); In re Interstate Dep't Stores, Inc., 128 B.R. 703, 705 (noting that the indispensable instrument represents the property right); In re CIL Co., 71 B.R. 261, 265-66 (Bankr. D. Or. 1987) (no pledge, no exclusive control).
control that a pledgee would have over collateral that was tangible in nature.96

To some extent, uncertainty existed because court opinions concerning what instruments or mechanisms satisfied the indispensable instrument requirement were by no means uniform. What resonated with most opinions was the requirement that creditors possess an instrument that evidenced the creditors' exclusive control over the deposit account pledged.97 In the absence of a comprehensive commercial statute, no certain rules outlining what steps were necessary to secure a pledge of deposit accounts existed under the common law. Parties employed varying means to achieve exclusive control of deposit accounts, and those recognized as effective by some courts were rejected by others.98

Traditionally, courts viewed the possession of the depositor's passbook as embodying the depositor's right to its account to the extent that the presentation of the passbook was necessary to withdraw funds.99 Courts reasoned that passbooks were indispensable instruments that reified depositors' intangible rights because the party in possession of the passbook had an exclusive right to such funds.100 Modern banking practices, however, have displaced the passbook method because an indispensable instrument embodying the depositor's rights does not exist for many deposit accounts.101 Moreover, modern bank enhancements allow depositors to

96 In re Interstate Dept. Stores, 128 B.R. at 706 (citing Miller, 540 F.2d at 563). See also Third Nat'l Bank, 589 F. Supp at 158 n.3 (stating the relationship between a depositor and a bank is that of a debtor-creditor); In re CIL Co., 71 B.R. at 265 (stating depositor no longer owns money it deposits in bank); Duncan Box & Lumber Co., 270 S.E.2d at 145-46 (finding that a bank had secured an effective pledge by establishing a reserve account that only the bank could access). 97 See Ban, supra note 13, at 497 (stating common law pledge required physical possession, and some courts required "sufficient control" for deposit accounts).
98 Id.
99 See Restatement of Security, supra note 11, § 1 cmt. e. The comment to Restatement states that "indispensable instruments include . . . savings bank books." See Peoples Nat'l Bank of Washington v. United States, 777 F.2d 459, 461-62 (9th Cir. 1985) (stating that "[a] pledge of a deposit account is effective only upon the transfer . . . of an indispensable instrument (i.e., one such as a passbook that is necessary to control of [sic] the account"); Miller, 540 F.2d at 562 (delivery of a passbook to a creditor constitutes a pledge); In re CIL Co., 71 B.R. at 266 (noting a passbook is an indispensable instrument); Orbaun v. First Nat'l Bank of Cloverdale, 8 P.2d 470 (Cal. 1932) (stating that "the mere delivery of a savings bank pass-book with the intent to pass title is sufficient to constitute an assignment by way of gift of the deposit"); Mierke v. Jefferson Cty. Sav. Bank, 101 N.E. 889, 890 (N.Y. 1913) (noting that a passbook was necessary to withdraw funds from the account); Myers v. Albany Sav. Banks, 270 A.D. 466, 469 (N.Y. App. Div. 1946); Dag Wilkinson, Third Party Interest in Deposit Account and the Bank's Right of Setoff, 109 Banking L.J. 247, 260 (1992).
100 See supra note 99.
101 See In re Section 20 Land Group, 261 B.R. 721, 728 (Bankr. M.D. Fla. 2001) (noting that "[m]odern courts have grappled with applying the common law pledge to the creation of a security interest in a deposit account, where there is no instrument specifically creating a pledge");
withdraw funds from their accounts without presentation of a passbook, thus rendering passbook possession ineffective to secure a pledge of the depositor's intangible chose in action.102

Without an indispensable instrument, creditors used varying control mechanisms in an attempt to obtain exclusive control consistent with the indispensable instrument requirement. Court opinions concerning what other mechanisms established such exclusive control varied considerably as courts applied varying analyses in determining whether the mechanisms established by creditors achieved the requisite control underlying the indispensable instrument requirement.103 Under such reasoning, reserve accounts containing deposit funds that are inaccessible to depositors were effective pledges, since the creditor maintained exclusive control of the account as with passbook possession.104 Other types of control mechanisms were viewed by some courts as effective but rejected by others.105 Control

102See Third Nat'l Bank, 598 F. Supp at 158 n.3 (noting a secured party can have an effective pledge of a deposit without having possession of a passbook provided the secured party has control of the deposit account in a manner that "prevent[s] a withdrawal from the account to the extent of the loan balance") (citing Treas. Reg. § 301.6323(b)-1(j)(2)(ii) (1976); 26 C.F.R. § 301.6323(b)-1(j)(2)(ii) (1976)); see also In re CIL Co., 71 B.R. at 265 (recognizing that modern day bank enhancements require control through other methods to prevent depositor from withdrawing funds from its deposit account).

103See In re Section 20 Land Group, 261 B.R. at 727.

104See Third Nat'l Bank, 598 F. Supp at 158 n.3 (holding the bank had an effective pledge since it had exclusive control of the account through an internal hold that restricted debtor access to the account); id. (opining that "26 U.S.C. section 6323(b)(10) [(1976)] clearly provides that the only way a security interest in a bank account can take priority over a federal tax lien is for the secured party to cut off the depositor's access to the funds completely"); Miller, 540 F.2d at 562-63 (holding a pledge ineffective because facts suggested the depositor retained access to the account despite creditor's possession of a telex code required to withdraw funds, and the creditor failed to prove that it had exclusive control of the account); In re Alabama Land & Mineral Corp., 292 F.2d 1319, 1326 (11th Cir. 2002) (stating that a pledge is not effective if the debtor retains control of the deposit account); In re Section 20 Land Group, 261 B.R. at 729 (holding the creditor had secured an effective pledge because the depositor could not withdraw funds from its deposit account); In re Interstate Dept Stores, Inc., 128 B.R. 703, 705 (Bankr. N.D.N.Y. 1991) (holding that bank had secured an effective pledge in a "blocked account" from which the creditor "had the exclusive right to withdraw money"); In re CIL Co., 71 B.R. at 266 (holding the bank had an effective pledge since it had exclusive control of the account through an internal hold that restricted debtor access to the account); Duncan Box & Lumber Co., 270 S.E.2d at 145 (holding a bank had secured an effective pledge by establishing a reserve account which only the bank could access); id. (dispensing with the indispensable instrument requirement where the creditor by contract established a reserve account in which it had exclusive control issue); Wilkinson, supra note 99, at 260-61.

105See Jefferson Bank & Trust v. United States, 684 F. Supp. 1542, 1547 (D. Colo. 1988) (finding that the bank had an effective pledge of depositor's general operating account even though it did not have exclusive control); Gilman v. Chase Manhattan Bank, 534 N.E.2d 824, 831 (N.Y.
mechanisms that failed to grant creditors exclusive control of the deposit accounts at issue were routinely rejected as ineffective.106

Confusion abounded concerning how to secure an interest in deposit accounts as court rulings varied; what one court viewed as an effective control mechanism was rejected by another. Written security assignments executed by some creditors to secure a pledge added to the confusion.107 Despite the common law requirement, some courts dispensed with the "indispensable instrument" requirement holding creditors' pledges as effective if the written security assignment contained precise language that defined the account, the creditor's exclusive right to its fund, and the creditor's security interest sufficient to secure a pledge.108 Other courts rejected written assignments that failed to contain the precise language, while others rejected written assignments not accompanied by an "indispensable instrument."109 Uncertainty was further fueled by court rulings that varied on whether deposit accounts were general intangibles or

1988) (finding a security agreement was effective to secure a pledge of a deposit account).

106Third Nat'l Bank, 589 F. Supp at 158 n.3 (opining that "26 U.S.C. section 6323 (b)(10) [(1976)] clearly provides that the only way a security interest in a bank account can take priority over a federal tax lien is for the secured party to cut off the depositor's access to the funds completely"); Miller, 540 F.2d at 562-63 (holding a pledge ineffective because facts suggested the depositor retained access to the account despite creditor's possession of a telex code required to withdraw funds); In re Interstate Dept Stores, Inc., 128 B.R. 703, 705 (Bankr. N.D.N.Y. 1991) (holding the creditor's pledge in a debtor's operating account ineffective because the creditor had "full use and control" of the account).

107See RESTATEMENT OF SECURITY, supra note 11, sec. 1 (recognizing a written security assignment as a pledge only if it is accompanied by an indispensable instrument).


109Peoples Nat'l Bank of Washington, 777 F.2d at 461 (holding that a security agreement purporting to convey a security interest in the depositor's account and funds maintained therein was ineffective to secure a pledge of the account and its funds because the bank failed to take possession of an indispensable instrument embodying the depositor's rights).
certificates of deposit subject to Article 9 filing requirements, rather than common law principles.\textsuperscript{110}

Other hurdles existed in jurisdictions where the common law was more certain. Control of deposit accounts required the cooperation of the depository bank, and a pledge or security assignment was impossible if the depositor's contract with its bank prevented such a pledge or assignment.\textsuperscript{111} The common law also failed to resolve priority disputes between Article 9 creditors asserting an interest in deposit accounts as proceeds and creditors asserting an interest in such accounts under the common law of pledges or security assignments.\textsuperscript{112} Even in jurisdictions with more certain coverage, deposit account financing under the common law involved greater expense than financing under Article 9.\textsuperscript{113} To address the uncertainty surrounding deposit account financing, some states, breaking ranks with the Former Article 9, amended their commercial codes to include deposit accounts as original collateral.\textsuperscript{114} The amendments, however, were non-uniform, adding to the legal uncertainty surrounding deposit account financing.

V. DEPOSIT ACCOUNTS UNDER REVISED ARTICLE 9

A. Overview

Revised Article 9 does not explicitly state deposit accounts as original collateral are within its scope; however, the revision only excludes assignments of deposit accounts in consumer transactions.\textsuperscript{115} The inference

\textsuperscript{110}See In re Alabama Land & Mineral Corp, 292 F.3d 1319 (11th Cir. 2002) (holding that under Revised Article 9 deposit account definition, found the funds at issue constituted a deposit account rather than certificates of deposit, and the creditor failed to secure an effective pledge of the accounts because it did not have control over the funds). See In re Latin Inv. Corp., 156 B.R. 102 (Bankr. D. D.C. 1993) (discussing, but ultimately holding, that a certificate of deposit account was not a deposit account).

\textsuperscript{111}SEPINUCK, supra note 12, at 507.

\textsuperscript{112}Id. at 507-08.

\textsuperscript{113}Id. at 508.

\textsuperscript{114}Id. at 479-80.

\textsuperscript{115}The comments accompanying Section 9-109(d)(13) indicate that 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. Article 9, however, does 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. The term includes consumer-goods transactions." See id. § 9-102(a)(26).

The drafter's decision to exclude deposit accounts stemmed from consumer advocacy groups' concerns that deposit account financing involving consumer accounts would grant creditors a "powerful 'sledgehammer' for forcing concessions from consumers in the event of a
can be drawn that deposit accounts as original collateral now join deposit account proceeds as personal property within the scope of Revised Article 9. Revised Article 9 defines deposit accounts as a "demand, time, savings, passbook, or similar account maintained at a bank," but the definition expressly excludes "investment property or accounts evidenced by an instrument." Revised Article 9 also rejects the intangible classification of deposit accounts asserted by courts under the common law, even though the debtor-creditor relationship between a bank and its customers supports that classification. Under that relationship, the depositor does not have possessor right in the funds deposited, but has an intangible right to recover the amount of funds deposited. Article 9's rejection of the intangible classification is most likely related to the assignment law provisions, which allow an obligee to assign its intangible property right

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." Harrell, supra note 13, at 72; see also Harris & Mooney, supra note 30, at 1366 (noting consumer advocacy groups were against the widespread collateralization of deposit account in consumer transactions).

The exclusion is not as restrictive as it may appear because the term "consumer transaction" does not preclude a business to assign a consumer deposit account to a creditor and allows a consumer debtor to incur an obligation secured by a commercial deposit account. See Rev. U.C.C. § 9-102(a)(26). In addition, the exclusion does not apply to funds maintained in a deposit account representing proceeds generated from the sale of Article 9 collateral held by a debtor for consumer purposes. Id.

The comments explicitly exclude deposit account financing concerning consumer transactions leaving coverage concerning laws other than Article 9. See id. § 9-109(d)(13) cmt. 16.

Revised Article 9 defines a bank 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." Rev. U.C.C. § 9-102(a)(8).

Id. § 9-102(a)(29). Article 8 of the U.C.C. governs purchase and sales transactions involving investment property. See generally Rev. U.C.C. art. 8 (describing rules governing investment securities). Revised Article 9, however, includes investment property, whether in a certificated or un-certificated form, within its scope. See id. § 9-109. Revised Article 9 defines investment property as "a security, whether certificated or un-certificated, security entitlement, securities account, commodity contract or a commodity account." Id. § 9-102(a)(49). It also provides perfection and priority rules for such collateral. See id. §§ 9-305, 9-312, & 9-328.

The revised rules define an instrument as "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." See id. § 9-102(a)(47). Certificates of deposits are considered deposit accounts if they are un-certificated and not evidenced by writing obliging the issuing bank to pay. Id. § 9-102 cmt. 12. Certificates of deposit that are in certificated form that obliges the issuing bank to pay the depositor are considered instruments. See id.

See Rev. U.C.C. § 9-102(a) cmt. 5d.

See supra note 89.

Id.
over the objection of its account debtor. 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. Depositors could assign their intangible chose in action property rights to third party assignees including secured creditors over the objection of their depositary banks. Also, Revised Article 9 provides that an assignee of an intangible right can perfect its interest by filing a financing statement. 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 the drafters viewed the depositor's right as tangible.

B. The Control Requirement

1. Perfection of Deposit Accounts

A creditor can only perfect a security interest in a deposit account by obtaining control of the account. A creditor 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. Both methods of control require the assent of the depositary bank maintaining the account and nothing in Revised Article 9 requires the bank to grant such assent.

Under both types of control, attachment is automatic once the creditor has control of the deposit account assuming "value has been given" and "the debtor has rights in the collateral or the power to transfer

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122 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 as one "obligated on an account, chattel paper, or general intangible." Id. § 9-102(a)(3).

123 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).

124 See id. § 9-406(f).

125 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.

126 See Rev. U.C.C. §§ 9-104(a), 9-314.

127 See id. § 9-104(a)(2)-(3).

128 Id.

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

right in the collateral to a secured party.\textsuperscript{131} 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.\textsuperscript{132} The revised rules, however, clearly state a bank does not have to enter a control agreement even if its depositor so wishes.\textsuperscript{133}

Revised Article 9 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.\textsuperscript{134} By liberalizing the control requirement, the creditor can allow the depositor access to the account without jeopardizing their perfection of the account.\textsuperscript{135} But such rules are significant only if banks assent to such agreements.

Creditors can also obtain control by becoming a customer of the depositary bank after establishing an account in their own name or jointly with its debtor.\textsuperscript{136} 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.\textsuperscript{137} For example, creditors can effectively block depositors' access to reserve accounts.\textsuperscript{138} Also, establishing such accounts will likely be less costly than negotiating control agreements from depositary banks, and presumably, less burdensome than establishing reserve accounts under the common law.\textsuperscript{139} Most importantly, this method of control grants

\begin{itemize}
  \item \textsuperscript{131}See id. § 9-203(b)(2).
  \item \textsuperscript{132}See id. § 9-104(a)(2).
  \item \textsuperscript{133}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)."
  \item \textsuperscript{134}See Rev. U.C.C. § 9-104(b) & cmt. 3. (2001). The control agreement 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. See generally McLaughlin, supra note 12, at 48 (describing Connecticut statute requiring exclusive control).
  \item \textsuperscript{135}Id. § 9-104(b) & cmt. 3.
  \item \textsuperscript{136}Id. § 9-104(a)(3); see also id. § 9-104 (providing rules related to establishing bank accounts).
  \item \textsuperscript{137}See Hillinger et al., supra note 12, at 31.
  \item \textsuperscript{138}See id.
  \item \textsuperscript{139}Id.; see also Harrell, supra note 13, at 71 (nothing that obtaining a pledge of a deposit account through establishing a special deposit account was costly and burdensome).
\end{itemize}
creditors priority against all competing claims—even those asserted by depositary banks.\footnote{Rev. U.C.C. § 9-327(1). Revised Article 9 also grants priority to a creditor asserting such control against a bank setoff's rights to such accounts. See \textit{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.\footnote{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.} Logically, 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 the ordinary course of their business. Moreover, banks typically exercise setoffs against these accounts to satisfy defaulted obligations.\footnote{See generally Wilkinson, \textit{supra} note 99 (describing the benefit banks gain with set-off rights).} 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.\footnote{See \textit{Hillinger et al., supra} note 12, at 49-50.} 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 limit the options of depositors and their creditors. Arguably, the restrictive nature of the control rules has laid the groundwork for a quasi-monopolistic market where banks dominate deposit account financing while shaping constructs under which such financing can occur by non-depositary bank creditors. If the control rules create such an environment, access to and the price of such financing may continue to restrict financing opportunities as they were known under the common law.

2. Priority Rules

The priority rules also favor banks. Revised Article 9 grants priority in deposits to banks maintaining control of accounts unless a creditor obtains control by establishing a special account in their name or along
with their debtor.\textsuperscript{144} The rules also grant priority to banks exercising setoff rights in a deposit account unless the creditor has established a special account.\textsuperscript{145} 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 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.\textsuperscript{146} 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 the kind of control that would subordinate their security interests.

The special nature of deposit accounts may render such a result desirable, especially given the role of deposit accounts in the payment system. Revised Article 9, however, contains no discussions concerning why banks were appointed 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-depository bank creditors. Nevertheless, designating banks as the protectorate of the system in which they can restrict creditor access to accounts while granting themselves unrestricted access is arguably akin to the fox guarding the hen house: Who is protecting the deposit accounts from the banks that maintain them?

\textsuperscript{144}Rev. U.C.C. § 9-327(4) (2001). See also id. § 9-104 cmt. 3 (describing control requirement).

\textsuperscript{145}See id. § 9-340(c) (2004).

\textsuperscript{146}See generally Wilkinson, supra note 99 (describing set-off rights).
VI. THE ARTICLE 8 CONTROL FRAMEWORK

A. Overview

The deposit account control rules were fashioned after the Article 8 control rules specifically designed to facilitate the trading of securities held through an indirect holding system. Presumably, one of the important factors that motivated Revised Article 9's adoption of the Article 8 control framework is the similarity between money market accounts, which are liquid cash assets, and deposit accounts. Under the indirect holding system, securities owners do not have actual or constructive possession of the physical stock certificates evidencing the securities comprising their securities account. Instead, their property interest is a security entitlement, which is a "package of rights and property interests" with respect to the securities comprising their securities account. The owners of the securities accounts are referred to as "entitlement holders." The physical stock certificates underlying the security entitlements are held by securities intermediaries, who grant entitlement credits to the securities accounts of entitlement holders when they purchase financial assets.

Since financial assets include securities and money market mutual funds shares, like deposit accounts, entitlement holders have access to the liquid

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147 The scope of Article 8 involves the settlement of trades and the rights and responsibilities of all parties involved in the settlement process. See generally U.C.C. § 8-101 (1994) (defining the scope of Article 8 of the UCC). Generally, publicly held securities are traded either through the direct or indirect holding system. This author discusses the control framework as it relates to securities traded through the indirect holding system, because the dynamics of the bank/customer relationship is most closely related to the dynamics of the securities intermediary/client relationship created under this system. Also, the majority of publicly held securities are traded through it and held by securities intermediaries on behalf of its clients. The control framework, however, also applies to the direct holding system in which securities owners take actual or constructive possession of the stock certificates purchased.

148 Article 8 provides that "a person has a security entitlement when a financial asset has been credited to a 'securities account' which includes accounts in which the broker holds cash assets in the form of 'money market mutual funds shares.'" Rev. U.C.C. § 8-501 cmt. 1 (1994). The definition of a financial asset includes a security or property held by a securities intermediary for its client if the securities intermediary agrees that it will hold the property as a financial asset. See id. § 8-102(a)(9).


151 See id. § 8-102(a)(14). Securities intermediary is defined as "clearing corporation; or person, including a bank or broker, that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity" Id.

152 See id. § 8-106(d)(1)-(2).
cash assets from which they can draw checks through a bank deposit account.\textsuperscript{153}

B. Article 8 and the Securities Holding System

Article 8 control rules were adopted to facilitate transfers of property interests in securities represented by securities entitlements.\textsuperscript{154} Since entitlement holders do not possess the actual stock certificates, a purchase of securities involves a transfer of an intangible property right, rather than a physical transfer of the stock certificates underlying the securities entitlements. The Article 8 control rules protect purchasers against claims of transferors if the purchasers have control of the security entitlement; thus, purchasers are free to sell or to transfer the securities underlying the entitlement "without further action by the transferor."\textsuperscript{155} Article 8 grants control to purchasers if "the securities intermediary has agreed that it will comply with entitlement orders originated by the purchaser without further consent by the [prior] entitlement holder."\textsuperscript{156} A purchaser also has control if she becomes the entitlement holder with respect to the security entitlement.\textsuperscript{157} These two control methods were adopted by Revised Article 9.

Sixty to eighty percent of the shares of publicly held companies are traded through the indirect holding system.\textsuperscript{158} The system consists of a multi-tiered layer of securities intermediaries including a clearing corporation, a depository trust company, brokers, and banks acting in a broker capacity. This is unlike the direct holding system, in which securities owners take physical possession of stock, or take constructive possession through a clearing corporation.\textsuperscript{159} Entitlement holders enjoy the financial benefits related to securities ownership, but they do so through their broker or bank, which executes trades according to customer

\textsuperscript{153}See id. § 8-106(d)(1)-(2).
\textsuperscript{154}See U.C.C. § 8-106 & cmt. 1.
\textsuperscript{155}Id. § 8-106 cmt. 7. "The key to the control concept is that the purchaser has the ability to have the securities sold or transferred without further action by the transferor." Id.
\textsuperscript{156}See id. § 8-106(d)(2).
\textsuperscript{157}Id. § 8-106(e).
\textsuperscript{158}See Securities Holding System, supra note 149, at 665. Sixty to eighty percent of the shares of companies publicly traded on the exchanges or OTC lists Cede & Company, a nominee name used by The Depository Trust Company (DTC), as the shareholder. Id.
\textsuperscript{159}In the direct holding system, either the issuer or its transfer agent registers the owner of the stock certificate, and issues a certificate with the owner's name on it. Id. at 664. Taking actual or constructive possession of securities or having ownership rights in un-certificated securities involves the direct holding system. See generally id. at 666 (providing an overview of the direct and indirect holding system). Registered owners have proxy rights and rights to receive dividends directly from the issue. Id.
instructions. Customers do not have a direct relationship with the issuer because the only name listed and registered as owner of stock certificates underlying security entitlements is Cede & Company, the nominee of the Depository Trust Company (DTC). When securities are traded, the ownership rights are transferred to the entitlement holder, but the physical stock certificates involved in the trade are held by the DTC, which serves as a securities depository for its members—"some six hundred or so broker-dealers and banks." The settlement and clearance of those securities underlying security entitlements commences with the National Securities Clearing Corporation (NSCC) and bears some similarities to the Federal Reserve check clearance and settlement system. The NSCC settles and clears the trades by netting reciprocal trade transactions between participating members of the NSCC. Instead of recording every trade executed by the entitlement holders who have traded securities, the NSCC records on its books "the net changes in the positions" of the brokers or banks that have executed trades on behalf of the entitlement holders trading that day. The NSCC also "instruct[s] DTC to make the corresponding adjustments" to the accounts of those brokers or banks executing trades on behalf of their customers. The brokers and bank participants whose accounts have been settled by the NSCC and recorded by the DTC provide clearance and settlement of payments for their customers by recording the change of positions to the entitlement holders' accounts.

C. Should Revised Article 9 Adopt the Article 8 Framework?

1. Similarities Between Securities and Banking Industry

In some respects, the adoption of the Article 8 control framework by Revised Article 9 is appropriate; both the banking and broker-dealer industry involve custodial relationships in which both the securities intermediaries and depositary banks hold financial assets on behalf of their

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160 Id. at 161, 166. The securities intermediary is required to transfer to the entitlement holder the "economic and corporate law rights of ownership" underlying the securities purchased through the indirect holding system. Id. at 166.
161 Id. at 159-60; see also James S. Rogers, Policy Perspective on Revised UCC Article 8, 43 U.C.L.A. 1431, 1444 (1996) (discussing the indirect holding system).
162 Securities Holding System, supra note 149, at 665.
163 Id.
164 Id.
165 Id.
166 Securities Holding System, supra note 149, at 665.
167 Id. at 666.
clients. In the securities industry, securities intermediaries must comply with customer instructions concerning securities trades; in the banking industry, a depositary bank maintaining funds must comply with its depositor's instructions concerning deposited funds.168 Similarly, a depositor does not have actual possession of deposited funds, nor does she have the right to withdraw the exact funds it deposited; "[a] deposit account, unlike a securities account, is simply a debtor-creditor relationship."169 Like Article 8, Revised Article 9 implemented the control framework to provide a means for depositors to transfer their "property rights and property interest" in their deposit accounts to creditors.

The NSCC and the Federal Reserve payment systems are somewhat similar in that both systems provide netting and settlement services for their members. The NSCC has a direct relationship with its securities intermediaries whose accounts it settles daily by netting positions based on the purchases and sales of the securities they maintain on behalf of their securities customers.170 The Federal Reserve also provides clearance and settlement of deposit account payments by netting and settling positions of the respective banks.171 Under both the securities and banking systems, the clearing entity provides settlement services at the custodial level. The NSCC and the Federal Reserve adjust the accounts of their securities intermediaries and bank members, respectively. Those entities the provide settlement services for their customers.

Article 9 has also previously relied on the Article 8 control rules. It utilizes the Article 8 control framework as a means of perfection for secured transactions involving security entitlements, as well as other types of investment property.172 Secured transactions involving money market mutual fund shares are particularly relevant to deposit account financing.173 Securities intermediaries can arrange deposit accounts on which customers can draw checks against their money market mutual funds shares.174 The money market mutual fund shares, which are liquid cash assets, are

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168 Relationships, however, between institutions and customers of deposit accounts and security accounts are governed by different laws. Id. at 678.
169 Id.
171 See Coleman, supra note 43.
173 A securities account consists of financial assets maintained by a securities intermediary on behalf of an entitlement holder. Id. § 8-501. Included within the definition of a financial asset is a share or other property interest "which is recognized in any area in which it is issued or dealt in as a medium for investment." Id. § 8-102(9)(ii). Money market accounts satisfy the "other property interest" characterization of a financial asset.
174 See Securities Holding System, supra note 149, at 678-79.
redeemed to honor checks drawn on the money market account. In some respects, secured transactions involving money market accounts are similar to secured transactions involving demand deposit accounts as both entitlement holders and depositors have deposit accounts on which they can draw checks.

2. Differences Between Banks and Securities Intermediaries

Nonetheless, the nature of deposit accounts differs from security entitlements. Even Article 8 discusses the difference. It states that "a deposit account is an entirely different arrangement" than a securities account in that it indicates that banks have a proprietary interest in deposited funds, while securities intermediaries hold assets for their entitlement holders. Unlike banks, securities intermediaries cannot use those assets for their own proprietary business.

This difference is significant. The policy reason underlying the Article 8 control framework was to insure the integrity of securities trades executed through an indirect holding system. Because the securities industry transitioned from a direct to indirect holding system in which clients possess a somewhat intangible property interest, the control framework provides an efficient means to transfer such interests to third parties and to protect against fraud. The control framework naturally complements the indirect holding system under which the majority of publicly traded stocks are held. The securities intermediary cannot use the financial assets for its proprietary business, thus eliminating the possibility that it would refuse control requests that are contrary to its financial benefit. In fact, securities intermediaries typically benefit financially from trade transactions through transactions fees. Most likely, securities intermediaries will only block securities entitlement conveyances when an entitlement holder wishes to convey a securities interest being held on margin.

175 Id.
176 Id.
177 Id.
178 Securities Holding System, supra note 149, at 678; see also Rev. U.C.C. § 8-501 cmt. 1 (noting the comment states a bank-depositor relationship is different than an intermediary-entitlement holder relationship because it is not a relationship "in which the holder of a financial asset has undertaken to treat the other as entitled to exercise the rights that comprise the financial asset in the fashion contemplated by the Part 5 rules." Id.
179 Securities Holding System, supra note 149, at 678.
180 See generally Rev. U.C.C. § 8-106 (describing control in the context of a securities account).
Conversely, Revised Article 9 has imposed the framework to restrain, rather than facilitate, voluntary and involuntary transfers of deposit accounts. The restraints are necessary to protect payment integrity, to a point. Unlike securities intermediaries, banks can employ deposit account funds for their financial benefit, which may cause them to restrict property transfers unnecessarily. Apparently, securities intermediaries are granted authority under the control framework with the assumption that they would not forestall purchases unless the transfer was inconsistent with the wishes of the entitlement holder. In contrast, banks can forestall control requests, even if doing so is inconsistent with their depositors' interests, and not necessary to protect the payment system. Only naivety could lead one to assume that banks would only exercise their veto power to protect the payment system. Since they have proprietary interests in the deposit accounts they maintain, one can reasonably assume they will likely use their authority to reject requests that conflict with their financial interest, even if the proposed transaction is not an apparent threat to the payment system.

VII. THE EFFICIENCY QUESTION

A. Overview

An ongoing debate exists concerning the social desirability of secured credit and the priority rules secured creditors enjoy at the expense of involuntary creditors such as wage claimants, tort victims, and other lien creditors whose claims are routinely subordinated to secured lenders when debtors default or file for bankruptcy.\(^1\) The debate is particularly relevant to deposit account financing. Proponents defend secured credit and the priority rules that secured creditors enjoy by referencing the efficiency of the priority rules in terms of resource allocation.\(^2\) They assert that creditors more willingly extend financing secured by collateral than they would otherwise, and the loan proceeds create a more liquid economy through the workings of supply-side economics. Without priority rules, creditors would face increased credit risks because lien creditors' interests might trump their now unsecured interest in the event of bankruptcy or

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\(^{2}\)See Klee, *supra* note 181, at 1469-70.
default. The increased risks would cause creditors to restrict lending activity to manage the risks. Thus, priority rules favoring secured creditors are justified because secured lending encourages an allocation of collateral resources that promote liquidity, even though the rules do so at the expense of lien creditors such as tort victims, who have incurred injuries, or wage/pension claimants whose livelihood is threatened.

At least one commentator has posited the control rules will bring greater efficiency to the overall deposit account financing market because the increased costs associated with obtaining control will dissuade lenders for which the deposit account collateral is unnecessary to secure financing. Instead, those lenders will utilize other collateral of the debtor, preserving the deposit account collateral for reliance creditors. This increases financing opportunities for debtors and allows them to maximize their wealth through a more efficient allocation of their resources. This analysis requires the presumption that depositary banks will only reject control requests made by non-reliance creditors, and that depositary banks will engage in the due diligence necessary to determine which creditors are reliance creditors. Nothing in Revised Article 9 restricts banks from refusing control requests even if a reliance creditor makes such a request, nor does the article impose upon the bank the duty of determining if a requesting party is a reliance creditor.

Law and economics scholars analyze legal rules to determine whether they promote allocative efficiency through the allocation of property to its "highest (competitively) valued use and sold at prices that reflect their (marginal) social cost to society." Applying this principle, the deposit account rules promote such efficiency if, through conveyance, they enable the depositor to put his property interest in the deposit account to its most valuable use consistent with principles of maximization of wealth and utility. Logically, a depositor can achieve such a conveyance only if he has access to competitive market prices offered by secured parties wishing to collateralize deposit accounts in exchange for funding. If depositary banks exercise their veto authority to close out competing parties when concern for payment system integrity is nonexistent, depositors would be faced with non-competitive market prices offered by their depository bank that becomes the sole supplier in deposit account loan

183Id. at 1469.
185Id.
186Id.
products. No market is perfectly competitive, but unnecessary restrictions result in over-inflated prices, rather than competitive ones, and unnecessarily restricts supply and demand to the detriment of the market and its participants.

Those positing that the deposit account rules promote allocative efficiency should consider how, and to what extent, banks' unnecessary vetoes of depositors' requeststoo grant control to outside creditors will impact the laws of supply and demand for deposit account loan products. Inflated prices may well restrict the market to demands by larger business entities to the exclusion of smaller businesses that may be dissuaded by the higher loan product prices. In such a case, the deposit account rules not only fail to promote an efficient allocation of the deposit account property interests of small businesses, but also limit these businesses from maximizing their wealth and utility with respect to their deposit account interests. While, in reality, markets are never perfectly competitive, unnecessary restrictions affect supply and demand to the detriment of the market. Ultimately, whether deposit account rules truly promote allocative efficiency will depend on whether banks properly use their discretion in granting control to outside creditors to further a healthy and competitive market for deposit account financing. A market that allows depositors to maximize the value of their property interests through an exchange employs the property to its highest valued use.

Employing allocative efficiency as a justification for the inclusion of deposit accounts as original collateral requires that deposit account rules provide safeguards that insure banks only use their veto power to protect the payment system. Without such safeguards, depositors will have limited opportunities to convey their interest to secured parties other than their depositary banks, which, as the sole supplier in the market, will most likely offer non-competitive prices.

B. Efficiency Models

One of the standards used to measure allocative efficiency of rules is the Pareto superior model. This model evaluates a rule by determining if it promotes exchanges that increase the utility of one of the transacting parties without making any other party worse off. In the Pareto superior analysis, efficiency is measured in terms of the value of the exchange and value is defined as the willingness of the parties to pay for resources

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188 Id.
offered in a competitive market. Applying that standard, a loan contract executed between parties enabling the exchange of property interests in deposit accounts is Pareto superior if the loan transaction creates a state where either the depositor or the creditor is made better off by the conveyance of property and the remaining party is not harmed. In a competitive market, rules enabling increased financing opportunities creates a market where depositors' property interests are placed to their highest valued use, as reflected by the willingness of both parties to engage in the property exchange.

Presumably, the voluntary nature of such transactions coupled with the willingness of the parties to execute them suggests that deposit account financing will increase the utility of at least one transacting party without negatively impacting the utility of the other. If both a secured party and a bank offer the depositor a loan advance secured by its deposit account where the loan offers are equal in amount, amortization, and terms, with the exception of the interest rate, the depositor would likely choose the offer with the lower interest rate. If the bank offers a higher interest rate, it can impede the secured party's offer by refusing its request to obtain control of the deposit account. By definition, the bank has a perfected security interest in its deposit account.

A loan transaction where a bank with a higher interest rate gains lending business by refusing a request to gain control by another secured creditor with a lower rate is not Pareto optimal. Pareto optimal is a term used to characterize an exchange of property where no other exchanges exist that are Pareto superior. The transaction is not Pareto optimal because an extension of credit by the secured party will make the depositor better off than the depositary bank exchange, which is at a higher interest rate.

Critiques of the Pareto model point to its limited real world use. The model cannot assess efficiency of rules in terms of their distributional consequences and social desirability. In the case of deposit accounts rules, the distributional consequences involve the effects the rules will have on involuntary creditors whose recourse to deposit accounts will likely be subordinated to secured creditors, especially banks asserting continuous perfected security interests in deposits by virtue of providing overdraft protection.

A less restrictive model of allocative efficiency is the Kaldor-Hicks model, which unlike the Pareto model recognizes the distributional

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190DAU-SCHMIDT & ULEN, supra note 187, at 9.

191Id. at 10-11; see generally Warren, supra note 181, at 1377 (criticizing economic analysis).
consequences of legal rules. The Kaldor-Hicks model describes legal rules as efficient if transacting parties achieve wealth provided the harm done (in terms of dollars) to any third party is outweighed by the wealth received by the transacting parties. Theoretically, the transacting parties could compensate the parties harmed, but no such condition is required. It is also limited in its analysis because it, like the Pareto superior standard, determines efficiency on the basis of wealth maximization rather than social good.

C. The Distributional Consequences of the Deposit Account Rules

1. Introduction

Opponents of secured credit criticize the limited usefulness of models that evaluate legal rules in terms of allocative efficiency; the models only measure efficiency in terms of economic value, which translates to willingness to pay. The manner in which the models define value limits their usefulness because they cannot resolve normative questions concerning which method of allocation is preferable from a standpoint of social desirability and ethical significance. Unlike an analysis of market decisions, opponents argue an analysis of legal rules must be evaluated not only in terms of value, but also in terms of their social benefit and ethical significance. One way to evaluate social and ethical concerns related to deposit account financing is to write deposit account rules with an eye towards the distributional consequences associated with favoring voluntary creditors to involuntary ones. This is particularly significant because the revised deposit account rules subordinate an involuntary creditor's garnishment claim to an account to the depositary bank offering overdraft protection for that account. Historically, garnishment creditors have had recourse to deposit account funds to satisfy judgment claims, especially tort victims, but under the new rules, their claims will be subordinated to a depositary bank merely if that bank offers overdraft protection.

192 Coleman, supra note 189, at 518-20.
194 id.
195 See generally Warren, supra note 181 (noting economic analysis is limited); see also Rasmussen, supra note 77, at 1100-01 (noting "lack [of] sufficient data").
196 See DAU-SCHMIDT & ULEN, supra note 187, at 10-11.
197 Id.
198 But see Warren, supra note 181, at 1377.
2. Distributional Consequences

A normative analysis of the deposit account rules from a distributional standpoint requires identifying circumstances where deposit account rules do not achieve distributive efficiency, and implementing alternative corrective solutions.\textsuperscript{199} Deposit account rules, especially the control rules that grant banks automatic perfection, provided banks extend overdraft protection to deposit accounts. Under those rules, involuntary creditors will likely lose recourse to deposit account funds to satisfy claims, since banks extending overdraft protection can assert a continuous perfected security interest in those funds. Before the revised rules, involuntary creditors could assert garnishment claims that had priority over bank setoffs if the claims were asserted before a bank exercised a setoff against the account. The revised rules will most likely subordinate the interest of involuntary creditors to banks' setoff rights, provided banks offer overdraft protection on accounts.\textsuperscript{200} The rules, in conjunction with overdraft protection, provide a basis on which banks can continuously forestall involuntary creditors, even when setoff claims have not accrued before garnishment notices are served. Consequently, the rules leave little, if any, recourse for involuntary creditors seeking to satisfy claims through garnishments.

Of particular concern is the effect such rules will have on tort victims and wage and pension claimants, all of whom seek satisfaction of their claims through garnishing deposit accounts.\textsuperscript{201} Prior to Revised Article 9, the primary creditor against whom involuntary creditors competed for deposit account funds were banks asserting setoff claims against account funds.\textsuperscript{202} Revised Article 9 deposit account rules open the market for deposit account financing by banks and perhaps other secured creditors. Thus, involuntary creditors will now have to compete not only against setoff claims, but also secured claims.

\textsuperscript{199}'Id.

\textsuperscript{200}Most likely, the uncertainty of deposit account financing under the common law forestalled many asset-based creditors from engaging financing in deposit accounts as original collateral.

\textsuperscript{201}'Klee, supra note 181, at 1467-68 (identifying the garnishment creditors most affected by Article 9 priority rules).

\textsuperscript{202}Notably, setoff claims could only occur if the depositor became obligated to its bank for a defaulted obligation, such as an overdraft or defaulted loan obligation. Laws vary by jurisdiction concerning the time of accrual of a setoff claim. Some state law state that a setoff claim automatically accrues once a depositor has incurred a bank obligation. Other states require an affirmative act by the bank, such as a book entry, before a setoff accrues. In those states, a default by the debtor is not sufficient for the setoff to accrue. The bank must engage in some affirmative act to evidence that it is exercising its setoff right.
Arguably, the revised rules not only provide an incentive for depositors to convey interests in deposit accounts to creditors to receive funding, but simultaneously avoid garnishment of their funds by involuntary creditors. The social and moral desirability of rules that enable debtors to escape the consequences of negligent or fraudulent actions is questionable. Also, the social and moral desirability of compensating voluntary creditors at the expense of involuntary creditors who do not have the freedom to choose the debtors is debatable.203 Should deposit account rules provide refuge for such creditors even if they promote allocative efficiency?

Opponents of priority rules also argue that the rules encourage debtors to engage in risky investments because debtors can externalize costs, such as tort liability, arising from risky investments.204 If the debtors' assets are collateralized, tort victims will be injured by risky investments made by tortfeasors because the victims will have no recourse against personal property to seek redress for their injuries; their claims will be subordinated to those of secured creditors.205 Arguably, the deposit account rules will enable debtors to externalize costs associated with risky investments to non-adjusting tort victims or any other involuntary parties to which the debtor is liable.206 Opponents of priority rules argue in favor of economic regulations that would internalize those costs, which would likely forestall some, if not all, risky investment activities of these businesses. As a consequence, businesses may have more assets to satisfy involuntary claims.207

Legal rules should not be fashioned simply to insure that resources are allocated according to their highest value. Above all, rules should be devised to insure human behavior is consistent with the ethical and moral ideals of society. Rules that enable commercial transactions contrary to those ideals should compel examination to determine if corrective

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203See Rasmussen, supra note 77, at 1103. The author notes that "some scholars drew on philosophy to question why it is appropriate to compensate voluntary creditors of a firm before compensating involuntary creditors. Voluntary creditors pick whom to deal with and on what terms; tort victims do not." Id.

204Id.

205Rasmussen, supra note 77, at 1100-01, 1103. Rasmussen notes that [l]aw and economic scholars have pointed out that this [priority rules] creates an incentive for firms to take excessive risk. . . . In deciding whether or not to undertake an investment, the firm thus does not expect to bear the full cost of failure. In particular, to the extent that a project causes injuries and the firm lacks sufficient assets to compensate the victims, the victims suffer the losses. Id. at 1103.

206Id. at 1100-01.

207See generally DAU-SCHMIDT & ULEN, supra note 187, at 25 (describing benefits of allocative efficiency).
amendments should be implemented. In light of the likely distributive consequences of the revised deposit account rules, corrective measures may be needed to address the concerns of involuntary creditors, especially interests that involve redress for injuries and reimbursement for lost income. Empirical studies would shed light on whether social costs associated with deposit account rules justify implementation of corrective measures. Such studies would require identifying those parties harmed by deposit account rules and obtaining data that quantifies that harm to determine whether voluntary creditors should always be preferred to involuntary creditors.

The social costs of deposit account rules are very significant. If involuntary creditors have little or no recourse to satisfy claims through deposit account funds, what resources are left to remedy injuries of parties who have not chosen their creditors? Tort victims, whose injuries are not compensated, wage claimants, whose livelihoods are threatened, and pension claimants, whose retirements are postponed, will likely be left without any recourse against debtor's deposit account funds, which historically have been the significant source from which these parties have satisfied claims. From an ethical and social perspective, should deposit account rules ignore their plight and encourage debtors to hide their assets through secured lending? Should the rules allow banks to triumph over these parties simply because they provide overdraft protection, even though the overdraft claims have not yet accrued? These are significant social issues implicated by the revised deposit account rules. These are issues that should be addressed, rather than hidden behind the curtain of allocative efficiency. Revised Article 9 does not address these issues and it appears the rules were adopted under the assumption that deposit account financing promotes an efficient deposit account market, notwithstanding the social and moral costs involved or concerns that banks might abuse their discretion.208

VIII. CONCLUSION

The deposit account rules adopted by Revised Article 9 provide banks with greater sovereignty over the deposit accounts they maintain. This is necessary to protect the liquidity of the accounts against unbridled lending. The rules fail to provide safeguards to insure that banks do not

208 See Warren, supra note 181, at 1379. The author notes that "Professors Harris and Mooney admit that, without empirical evidence, it is hard to estimate the actual effects of a full priority system." She notes, however, that there are "no studies of efficiency, distributive consequences or any other aspect of Article 9" present during the drafting process. Id.
abuse their authority. The rules also fail to consider how bank sovereignty will affect involuntary lien creditors that historically have had access to deposit accounts to satisfy liens. Revised Article 9 contains no discussion concerning these matters. Rather, it only summarily states that deposit accounts were included to increase financing opportunities. Control rules were adopted presumably to prevent non-reliance lending. Moreover, the stated reason for the inclusion of deposit accounts is somewhat disingenuous in light of the restrictive perfection rules. Banks emerge as the only winner because they can use their new found power to protect their financial interests.

The most effective way to promote deposit account financing without endangering the payment system and without squeezing out involuntary creditors is to limit perfection to exclusive control. This method was endorsed by courts under the common law without disruption to the payment system. Applying exclusive control, outside creditors would be required to establish special accounts to collateralize deposit accounts for financing purposes. Banks would not have automatic perfection in any of the accounts they maintain. Like all other creditors, banks would have to establish special accounts to collateralize deposit accounts, and they could exercise setoff against both special accounts and any operating accounts they maintain on behalf of their depositors. Like Revised Article 9 rules, banks would be restricted from exercising setoff rights against a special account established in the name of another secured party. Exclusive control protects payment integrity by limiting credit foreclosures to accounts specifically designed as collateral; thus, it is less likely that payment settlement issues will be implicated. Exclusive control also protects the interests of involuntary creditors because it leaves general operating accounts available for garnishment purposes.

Limiting perfection to exclusive control also resolves the notice problems currently present in Revised Article 9. Revised Article 9 does not permit filed financing statements to perfect a security interest in deposit accounts, and it provides that banks have the right to refuse to disclose that they have entered a control agreement unless their depositor so requests. Instead, Revised Article 9 notes that all existing and potential creditors are always on notice that banks maintaining the deposit account "may assert a claim against" them.209 Exclusive control readily places creditors on notice of conflicting interests upon learning the nature of the account and grants

209See Rev. Art. 9 § 9-104 cmt. 3.
priority to the named creditor consistent with the existing priority rule for creditors that establish accounts in their name.210

This method of control functioned well under the common law. Presumably, Revised Article 9's departure from the common law stemmed from uncertainty regarding how to establish control of deposit accounts. While courts varied on what control mechanisms created an effective pledge, they uniformly agreed that the establishment of special accounts from which the depositor could not withdraw funds created an effective pledge in favor of the secured party. Adding deposit account financing within the scope of Revised Article 9 resolves issues of uncertainty and likely will reduce the costs of establishing reserve accounts. Limiting financing to exclusive control through the establishment of special accounts resolves payment integrity and non-reliance lending issues, and promotes distributive efficiency as it relates to involuntary creditors. Rules promoting deposit account financing through special accounts also promote allocative efficiency by enabling depositors to choose the creditor from which they desire to obtain financing, where the depositor's choice will be motivated by a desire to maximize his wealth and utility. The only question remaining is whether banks will cooperate with creditors seeking to establish special accounts for themselves.

210See id. § 9-327(4). (The priority rule also grants the creditor priority over setoff rights asserted by the bank.) See also id. § 9-340(c) (providing a secured creditor asserting control by becoming a customer of the deposit account has priority over a bank exercising setoff rights against the account).