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Security Interests in Deposit Accounts, Securities Accounts, and Commodity Accounts: Correcting Article 9's Confusion of Contract and Property

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SECURITY INTERESTS IN DEPOSIT ACCOUNTS, SECURITIES ACCOUNTS, AND COMMODITY ACCOUNTS: CORRECTING ARTICLE 9'S CONFUSION OF CONTRACT AND PROPERTY

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Abstract

Article 9 of the Uniform Commercial Code governs security interests in collateral consisting of personal property to secure payment or performance of an obligation. Most of the types of collateral subject to a security interest are things or property items in which one can have a property interest. The defined terms for the types and subtypes of collateral consisting of deposit accounts, securities accounts, commodity accounts, and commodity contracts, however, are not property items in which any person can have an ownership or security interest. Instead, they are contractual relationships. Designating these contractual relationships as property items—a confusion of contract and property concepts—creates difficulties and ambiguities in the application of Article 9 property law rules for the creation, perfection, priority, and enforcement of security interests in the rights arising from these relationships. In some cases, this confusion has produced errors in the rules themselves. This article

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proposes a revision, and pending such revision, a method of interpretation of Article 9 that would allow these provisions to function as intended.

Table of Contents

I. Introduction 340
II. Deposit Account and the Deposit Entitlement 346
A. The Deposit Entitlement as the Collateral Type 347
B. The Deposit Entitlement to Identifiable Cash Proceeds 356
C. Appropriate Use of the Term "Deposit Account" 358
III. Securities Account: Redundancy and Error 361
A. Securities Accounts and the Indirect Holding System for Securities 361
B. Elimination of the Securities Account Subtype 368
C. Drafting Error in Control of a Securities Account 372
D. Drafting Error and the Gap in the Priority Rules for Security Entitlements 382
E. Other Errors in Attachment and Perfection for Securities Accounts 385
IV. Commodity Account, Commodity Contract, and the Commodity Entitlement 390
A. The Commodity Entitlement as the Subtype of Collateral 390
B. A Specific Default Rule for the Commodity Entitlement 395
V. Conclusion: Interpretation and Revision 396

I. Introduction

Article 9 of the Uniform Commercial Code (the "UCC")[1] empowers any owner of personal property to create security interests in almost every kind of personal property[2] to secure payment or performance of an obligation.[3]

1. The current Official Text reflects the revised Article 9 that took effect in all of the States and the District of Columbia (with some non-uniform amendments) between July 1, 2001 and January 1, 2002. *See* UNIF. COMMERCIAL CODE, 3 U.L.A. 11-18 (2012). These revisions have been enacted in all of the States and the District of Columbia (again, with some non-uniform amendments). *See also* U.C.C. § 9-801 (AM. LAW INST. & UNIF. LAW COMM'N 2010) (establishing a uniform effective date of July 1, 2013); *Acts: UCC Article 9 Amendments (2010)*, UNIF. LAW COMM'N, http://www.uniformlaws.org/Act.aspx?title=UCC%20Article%209%20Amendments%20(2010) (last visited June 3, 2017).

2. Section 9-109(a) of the UCC states: "Except as otherwise provided in subsections (c) and (d), this article applies to: a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract . . . ." U.C.C. § 9-109(a). Article 9 does exclude certain transactions, the most significant of which is the exclusion of transfers of interests in or claims under most insurance policies. *See id.* § 9-109(d).

The particular thing or property item that is subject to a security interest is "collateral"[4] that is typically owned by a "debtor."[5] Article 9 classifies the universe of things or property items that can become collateral into thirteen different "types," such as goods or accounts, all of which are enumerated in the definition of "general intangible."[6] Further, some types of collateral include subtypes. For example, the type designated as "investment property," which has particular relevance in this article, consists of the subtypes "security," "security entitlement," "securities account," "commodity contract," or "commodity account."[7]

The drafters of Article 9 created these types and subtypes to ensure that Article 9's rules for governing security interests adequately reflect the nature of the particular property item and the nature of the transaction involving the particular property item.[8] For example, the methods for creating a security interest prescribed by Section 9-203(b) can vary

3. *See id.* § 1-201(b)(35). A security interest also includes the interest of a buyer of accounts, chattel paper, payment intangibles, or promissory notes. *Id.*

4. *See id.* § 9-102(a)(12) (providing that the term "collateral" "means the property subject to a security interest").

5. *See id.* § 9-102(a)(28) (defining the "debtor" as "a person having an interest, other than a security interest or other lien, in the collateral"). The word "property" in the definitions of debtor, security interest, and collateral is ambiguous. *See id.* §§ 1-201(b)(35), 9-102(a)(12). The word "property" could have the colloquial meaning of the thing or property item in which one or more persons can have a property interest, or it can have the legal meaning of the property interest in the property item, such as an ownership interest, leasehold interest, or security interest. In some circumstances this distinction may be important. For example, if a debtor owns a one-half interest in an item of equipment, it can only grant a security interest in that one-half interest and not in the item itself. *See* Thomas E. Plank, *Article 9 of the UCC: Reconciling Fundamental Property Principles and Plain Language*, 68 BUS. LAW. 439, 450-55 (2013). Nevertheless, the object of every security interest is ultimately a property item. This article analyzes the "property items" that constitute collateral or underlie collateral.

6. A "general intangible" is "any personal property, including things in action, other than [1] accounts, [2] chattel paper, [3] commercial tort claims, [4] deposit accounts, [5] documents, [6] goods, [7] instruments, [8] investment property, [9] letter-of-credit rights, [10] letters of credit, [11] money, and [12] oil, gas, or other minerals before extraction." U.C.C. § 9-102(a)(42); *see also id.* § 9-102 cmt. 5(d) (describing a "general intangible" as "the residual category of personal property, including things in action, that is not included in the other defined types of collateral").

7. *See id.* § 9-102(a)(49).

8. *See generally* Plank, *supra* note 5 (describing how the rules for perfecting security interests to secure a debt reflect the nature of the different types of collateral and the nature of the transactions involving such collateral, but the rules for the assignment of receivables fail to do so).

depending on the type of collateral.[9] The rules for perfecting security interests[10] and for the priority among security interests[11] also vary by type.

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9. Section 9-203(b)of the UCC states:

> Except as otherwise provided in subsections (c) through (i), a security interest is enforceable against the debtor and third parties with respect to the collateral only if :
>
> (1) value has been given;
>
> (2) the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and
>
> (3) one of the following conditions is met:
>
> (A) the debtor has authenticated a security agreement that provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned;
>
> (B) the collateral is not a certificated security and is in the possession of the secured party under Section 9-313 pursuant to the debtor's security agreement;
>
> (C) the collateral is a certificated security in registered form and the security certificate has been delivered to the secured party under Section 8-301 pursuant to the debtor's security agreement; or
>
> (D) the collateral is deposit accounts, electronic chattel paper, investment property, letter-of-credit rights, or electronic documents, and the secured party has control under Section 7-106, 9-104, 9-105, 9-106, or 9-107 pursuant to the debtor's security agreement.

U.C.C. § 9-203(b).

10. For example, filing a financing statement is necessary to perfect a non-possessory security interest in inventory and equipment. *See id.* § 9-310(a) (providing that, with exceptions set forth in subsection (b), "a financing statement must be filed to perfect all security interests"). No filing, however, is necessary to perfect a purchase money security interest in consumer goods. That security interest is perfected automatically upon attachment. *See id.* § 9-310(b) (providing that the "filing of a financing statement is not necessary to perfect a security interest . . . (2) that is perfected under Section 9-309 when it attaches"); *see also id.* § 9-309 (providing that the "following security interests are perfected when they attach: (1) a purchase-money security interest in consumer goods [except for goods subject to a certificate of title statute under § 9-311]"). A security interest in money may be perfected only by possession. *Id.* § 9-312(b)(3).

11. *Compare id.* § 9-324(a) (providing that "a perfected purchase-money security interest in goods other than inventory . . . has priority over a conflicting security interest in the same goods . . . if the purchase-money security interest is perfected when the debtor receives possession of the collateral or within 20 days thereafter"), *with id.* § 9-324(b) (providing that "a perfected purchase-money security interest in inventory has priority over a conflicting security interest in the same inventory . . . if . . . the purchase-money security interest is perfected when the debtor receives possession of the inventory [and] the purchase-money secured party" notifies the holder of the conflicting security interest that it has or expects to acquire a purchase-money security interest in the inventory); *compare also id.* § 9-330(b) *with id.* § 9-330(d) (both providing that a purchaser of tangible chattel paper and of an instrument that acquires possession in good faith and without knowledge that the

Article 9 defines most of the types and subtypes of collateral by a particular category of property items . For example, "goods" are "all things that are movable when a security interest attaches."[12] An "account" is a "right to payment of a monetary obligation" for certain specified purposes.[13] Each of these types consists of a category of tangible or intangible property items in which a person can have an ownership interest or security interest.

There are, however, four exceptions: the type "deposit account" and the subtypes of the type "investment property" consisting of "securities accounts," "commodity accounts," and "commodity contracts." As described in greater detail below in Parts II through IV, each of these types of collateral are by definition specialized contractual relationships. Each of the parties to these contractual relationships have rights that constitute property items that a person can own or a person can subject to a security interest. The contractual relationships themselves, however, are not property items.

A simple contract for the purchase and sale of goods illustrates the difference between a contract and the rights under a contract that is a property item. The contract is a relationship. Although the buyer or the seller as a party to a contract may refer to "my contract" with the other party, neither the seller nor buyer can own the contract. Instead, the seller or buyer owns the rights under the contract. The seller has the right to the payment for the goods conditioned upon the seller's delivery of the goods to the buyer. The buyer has the right to the delivery of the goods, conditioned upon the buyer's payment to the seller of the purchase price of

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purchase violates the rights of the secured party may have superpriority over a security interest perfected other than by possession, but priority for chattel paper also requires purchase for "new value" and in ordinary course and priority for instrument requires only purchase for "value").

12. *Id.* § 9-102(a)(44). Goods also include certain "computer program[s] embedded in goods but do not include computer programs embedded in goods that consist solely of the medium in which the program is embedded." *Id.* No doubt to remove any ambiguity about the breadth of the term "things that are movable," the definition further provides that goods do not include "accounts, chattel paper, commercial tort claims, deposit accounts, documents, general intangibles, instruments, investment property, letter-of-credit rights, letters of credit, money, or oil, gas, or other minerals before extraction." *Id.*

13. *Id.* § 9-102(a)(2) (defining an "account" as a right to payment of a monetary obligation "(i) for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, (ii) for services rendered or to be rendered" and for other specified purposes).

the goods.[14] The seller's right to payment, which is an account under Article 9,[15] and the buyer's right to delivery of the goods, which is a general intangible under Article 9,[16] are property items that have value, that can be assigned, and that exclude any other person from exercising their respective rights. Article 2 recognizes that a contract itself is not a property item that can be sold. Section 2-210(5) provides that an assignment of a contract is (a) an assignment of rights under the contract and (b) unless the language indicates to the contrary, a delegation of duties under the contact.[17]

Each of the definitions of deposit account, securities account, commodity account, and commodity contract are essential to the operation of Article 9. The terms, however, should not be designated types or subtypes of collateral. Designating these contractual relationships as property items—essentially, confusing contracts for property—creates ambiguity and difficulties in drafting, interpreting, and applying the important property law rules[18] for the creation, perfection, priority, and enforcement

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14. *See id.* § 2-507(1) (providing that "[t]ender of delivery is a condition to the buyer's duty to accept the goods and, unless otherwise agreed, to his duty to pay for them. Tender entitles the seller to acceptance of the goods and to payment according to the contract"); *id.* § 2-703 (providing that if the buyer repudiates the contract the seller may withhold delivery); *see also id.* §§ 2-106(3)-(4), 2-711 (providing that if the seller fails to deliver conforming goods, the buyer has the right to cancel the contract and is relieved of the obligation to pay the purchase price); RESTATEMENT (SECOND) OF CONTRACTS § 237 (AM. LAW INST. 1981) ("Except as stated in § 240 [part performance as agreed equivalents], it is a condition of each party's remaining duties to render performances to be exchanged under an exchange of promises that there be no uncured material failure by the other party to render any such performance due at an earlier time.").

15. *See* U.C.C. § 9-102(a)(2), *quoted supra* note 13.

16. *See id.* § 9-102(a)(42), *quoted supra* note 6.

17. *See id.* § 2-210(5) ("An assignment of 'the contract' or of 'all my rights under the contract' or an assignment in similar general terms is an assignment of rights and unless the language or the circumstances (as in an assignment for security) indicate the contrary, it is a delegation of performance of the duties of the assignor and its acceptance by the assignee constitutes a promise by him to perform those duties.").

18. Unlike Article 2 of the UCC, Section 365 of the United States Bankruptcy Code confuses an executory contract with the rights and liabilities of the parties to an executory contract. Section 365(a) states that, with certain exceptions, a bankruptcy trustee "subject to the [bankruptcy] court's approval, may assume or reject any executory contract or unexpired lease of the debtor." 11 U.S.C. § 365(a) (2012). This language is imprecise. In legal reality, the bankruptcy trustee may accept or reject not the contract itself but the obligations of the debtor under the contract. The imprecision of this language led to much confusion in the application of this section. Only after several influential law review articles and a number of cases has a consensus emerged that clarifies the meaning of the statutory language. *See, e.g.*,

of security interest in the rights arising from these relationships. This article proposes the elimination of these contractual relationships as types or subtypes of collateral, the creation of new defined terms to recognize the rights that arise out of the contractual relationships that constitute deposit accounts and commodity accounts, and other revisions to correct the errors that have arisen from treating these relationships as is if they were property items. Ultimately, these changes will require a revision of Article 9, but pending such legislative revision, courts and lawyers should, by implication, supply the necessary revisions where possible to ensure the intended function of the creation, perfection, priority, and enforcement of security interests in these types and subtypes of collateral.

Specifically, a new defined term, "deposit entitlement," should replace the term "deposit account" as a collateral type. A deposit entitlement consists of the rights of the customer arising out of the deposit account relationship. Similarly, a new defined term, "commodity entitlement," comparable to the existing subtype "security entitlement," should replace the terms "commodity account" and "commodity contract" as a collateral subtype. A commodity entitlement consists of the rights of the commodity customer arising out of the commodity account relationship with a commodity intermediary regarding commodity contracts credited to or carried in the commodity account.

Further, these terms should replace the terms "deposit account," "commodity account," and "commodity contract," as applicable, in critical sections governing the creation, perfection, priority, and enforcement of security interests. Pending such revision, those interpreting and applying

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Top Rank, Inc. v. Ortiz (*In re* Ortiz), 400 B.R. 755, 762-65 (Bankr. C.D. Cal. 2009) (noting that "[t]he law regarding rejection of executory contracts in bankruptcy has been the subject of much confusion; one court has described it as 'murky and confusing'" (quoting *In re* Bergt, 241 B.R. 17, 21 (Bankr. D. Alaska 1999)); Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection,"* 59 U. COLO. L. REV. 845, 861 (1988) (arguing that to "assume" a contract means merely to incur an obligation by admitting the contract into the estate while "rejecting" a contract means nothing more than to "elect . . . to leave matters as they were . . . . Rejection was nothing more than the label for the decision not to assume" (emphasis omitted)); Jay Lawrence Westbrook, *A Functional Analysis of Executory Contracts*, 74 MINN. L. REV. 227, 230 (1989) (stating that "assumption and rejection" are "merely bankruptcy terms for performance or breach by the trustee"); Michael T. Andrew, *Executory Contracts Revisited: A Reply to Professor Westbrook*, 62 U. COLO. L. REV. 1, 2 (1991) ("Departing from the view of many of the cases, for example, [Professor Westbrook and the author] agree that rejection does not cancel, repudiate, or terminate contracts . . . and that rejection does not, like bankruptcy law's 'avoiding powers,' terminate state-law rights in or to specific property." (footnote omitted)).

these current critical provisions should interpret the terms deposit accounts, commodity accounts, and commodity contracts, as applicable, to mean these corresponding deposit entitlements or commodity entitlements. These interpretations and revisions are especially important for understanding and applying Article 9's rules for security interest in proceeds consisting of a deposit account as discussed in Part II.B below.

Securities accounts present a different problem. Articles 8 and 9 have already created a term—the "security entitlement" —that defines the rights of a person—the "entitlement holder" —arising out of a securities account. Also, a security entitlement is already defined as a subtype of investment property. The use of securities account as a subtype of collateral is completely unnecessary. In addition, the provisions governing the creation, perfection, and priority of a security interest in a securities account contain drafting errors that defeat the purpose of each of these provisions. In particular, the erroneously drafted rules create a hole in the Article 9 priority scheme for security entitlements. A revision of Article 9 should eliminate "securities account" as a subtype of collateral, eliminate the current provisions for creation, perfection, and control of a security interest in a securities account, and revise the priority rules for security entitlements to close the hole in the priority rules for security interests in security entitlements.

II. Deposit Account and the Deposit Entitlement

The concept of a deposit account, but not the express definition, first appeared in the 1962 Official Text of the UCC enacted throughout the United States. Section 9-104(k) of the 1962 UCC stated that Article 9 did not apply to "any deposit, savings, passbook or like account maintained with a bank, savings and loan association, credit union, or like organization."[19] The 1972 revision of Article 9 added a definition of deposit

19. *See* U.C.C. § 9-104(k) (1962) (superseded 2001, as amended 2010). Comment 7 of the 1972 official text to this section stated the reason for the exclusion: "Rights under life insurance and other policies, and deposit accounts, are often put up as collateral. Such transactions are often quite special, do not fit easily under a general commercial statute and are adequately covered by existing law." *Id.* § 9-104 cmt. 7 (1972). *See generally* Bruce A. Markell, *From Property to Contract and Back: An Examination of Deposit Accounts and Revised Article 9*, 74 CHI.-KENT L. REV. 963, 966-74 (1999) (providing a brief history of the law governing deposit accounts).

account that was substantially similar to this phrase.[20] The purpose of this addition was to include deposit accounts as cash collateral and proceeds.[21] Deposit accounts, however, did not constitute a type of collateral and, except for the treatment of proceeds, the official text of Article 9 did not apply to deposit accounts.[22] A few states enacted non-uniform amendments that included a deposit account as collateral, not as a separate type, but as a general intangible.[23] Deposit accounts first became a type of collateral in the 2001 revision of the Official Text of Article 9.[24]

A. The Deposit Entitlement as the Collateral Type

People often assume that their checking account, which is a deposit account, is "theirs" and also consider the "funds" credited to that account as "their" money. These sentiments, however, are not legal reality. A checking account or other kind of deposit account is a debtor-creditor relationship between a customer and a bank.[25] When the customer deposits funds in the

20. *See* U.C.C. § 9-105(e) (1972) (superseded 2001, as amended 2010). The definition is the same as the phrase in U.C.C. § 9-104(k) (1962) plus the addition of the words "other than an account evidenced by a certificate of deposit." *See id.*

21. *See* UNIF. COMMERCIAL CODE app. V, References & Annot. cmt. E-26, 3A U.L.A. 240, 253 (2002).

22. *See* U.C.C. § 9-106 (1972) (superseded 2001, as amended 2010) (not including deposit accounts in the list of types in the definition of general intangibles). The exclusion for deposit accounts was set forth in Section 9-104(l): "This Article does not apply . . . (l) to a transfer of an interest in any deposit account (subsection (1) of Section 9-105), except as provided with respect to proceeds (Section 9-306) and priorities in proceeds (Section 9-312)." *Id.* § 9-104(l) (1972) (superseded 2001, as amended 2010). The comment providing the rationale for the exclusion remained unchanged. *Id.* § 9-104 cmt. 7 (1972) (superseded 2001, as amended 2010).

23. For example, California's UCC eliminated deposit accounts from the transactions excluded from Article 9 by U.C.C. § 9-104(l). *See* CAL. COM. CODE § 9104 (West 1997). However, because California did not add deposit account as a type of collateral, a deposit account was treated as a general intangible. *See* Parker v. Cmty. Bank (*In re* Bakersfield Westar Ambulance Inc.), 123 F.3d 1243, 1246-48 (9th Cir. 1997) (discussing how a secured party could obtain a security interest in a deposit account but holding that this secured party failed to obtain a security interest because of an insufficient description of the collateral). Other states that did not exclude deposit accounts from Article 9 were Hawaii, Idaho, Illinois, and Louisiana. *See* Markell, *supra* note 19, at 972-73.

24. *See* U.C.C. § § 9-102(a)(12).

25. *See* U.C.C. § 9-102(a)(29) (defining a "deposit account" as "a demand, time, savings, passbook, or similar account maintained with a bank," but not including "investment property or accounts evidenced by an instrument"). The term "bank" is defined as "a person engaged in the business of banking . . . includ[ing] a savings bank, savings and loan association, credit union, or trust company." *Id.* § 1-201(b)(4). This definition was previously defined in Section 4-105. *See id.* § 4-105(1) (1990) (amended 2010); *see also id.*

deposit account, the customer is making a loan to the bank. The bank credits the amount of funds to the customer's deposit account. The customer has the right to instruct the bank regarding the use of the amount of funds credited to the deposit account and also has other rights and duties stated in the agreement creating the deposit account or specified by applicable law. The bank owes an obligation to the customer[26] and has

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§ 4-104(a)(1), (5) (1990) (amended 2010) (defining an "account" as "any deposit or credit account with a bank, including a demand, time, savings, passbook, share draft, or like account, other than an account evidenced by a certificate of deposit" and a "customer" as "a person having an account with a bank or for whom a bank has agreed to collect items, including a bank that maintains an account at another bank"); *id.* § 4-401(1) (1990) (amended 2010) ("A bank may charge against the account of a customer an item that is properly payable from the account even though the charge creates an overdraft. An item is properly payable if it is authorized by the customer and is in accordance with any agreement between the customer and bank."); Markell, *supra* note 19, at 966-67 (describing the evolution of the bank account from a property-based, custodial arrangement into a contractual relationship).

I use the citations to the 1990 Official Text of Articles 3 and 4 instead of the revisions to Articles 3 and 4 adopted by the American Law Institute and the Uniform Law Commission in 2002. As of May 15, 2016, those revisions have been adopted in only twelve states (including the District of Columbia). *See Acts: UCC Article 3, Negotiable Instruments and Article 4, Bank Deposits (2002)*, UNIF. LAW COMM'N, http://www.uniformlaws.org/Act.aspx?title=UCC%20Article%203,%20Negotiable%20Instruments%20and%20Article%204,%20Bank%20Deposits%20(2002) (last visited June 3, 2017).

The 1990 revision of Article 3 remains in effect in most of the states (but not New York, which still uses the 1962 version of Article 3 with some modifications). *See Acts*: *UCC Article 3, Negotiable Instruments (1990)*, UNIF. LAW COMM'N, http://www.uniformlaws.org/Act.aspx?title=UCC%20Article%203,%20Negotiable%20Instruments%20(1990) (last visited June 3, 2017). However, there is no difference in the cited sections between the versions.

26. That term "deposit" by itself often refers to the liability of the bank. Section 3(l) of the Federal Deposit Insurance Act (the "FDI Act") defines "deposit" as follows:

> The term "deposit" means--
>
> (1) the unpaid balance of money or its equivalent received or held by a bank or savings association in the usual course of business and for which it has given or is obligated to give credit, either conditionally or unconditionally, to a commercial, checking, savings, time, or thrift account, or which is evidenced by its certificate of deposit, thrift certificate, investment certificate, certificate of indebtedness, or other similar name, or a check or draft drawn against a deposit account and certified by the bank or savings association, or a letter of credit or a traveler's check on which the bank or savings association is primarily liable . . . .
>
> . . . .
>
> (5) such other obligations of a bank or savings association as the Board of Directors, after consultation with the Comptroller of the Currency, and the Board of Governors of the Federal Reserve System, shall find and prescribe by

other duties and rights stated in the deposit account agreement.[27] The bank, by book entry, keeps track of the amount of funds that it is obligated to pay pursuant to the instructions of the customer, and the funds credited to the deposit account are nothing more than a book-entry credit balance owed by the bank.[28]

A deposit account is not a property item that can be owned. Indeed, the only person that has dominion over the deposit account is the bank, the obligor. The customer cannot possess or control a deposit account. Instead, the customer can own and control the rights arising from the deposit account relationship—primarily, the right to direct the bank to dispose of the amount of funds credited to the deposit account. As noted above, this article refers to these rights as a deposit entitlement.[29] The customer owns the deposit entitlement and can use its deposit entitlement—that is, the customer can direct the disposition of the amount of funds credited to the deposit account. The deposit entitlement is a property item that is generally subject to garnishment for the payment of judgments.[30] Since the enactment

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> regulation to be deposit liabilities by general usage [with certain exceptions] . . . .

12 U.S.C. § 1813(*l*) (2012). A deposit under the FDI Act is broader than a deposit account because it includes a balance evidenced by a certificate of deposit, which may be excluded from deposit account if the certificate of deposit is an instrument. *See* U.C.C. § 9-102(a)(24), *quoted supra* note 25 (defining "deposit account"); *see also* McFarland v. Brier, 850 A.2d 965 (R.I. 2004) (holding that a particular certificate of deposit by a bank was a non-negotiable "instrument" under Article 9 instead of a general intangible or a deposit account, a security interest in which could be perfected possession).

27. *See* sources cited *supra* note 25.

28. If the deposit account is a checking account, the customer provides these instructions by issuing a "check", which is "a draft, other than a documentary draft, payable on demand and drawn on a bank." U.C.C. § 3-104(f) (1990) (amended 2002). A "draft" is an "order," *see id.* § 3-104(c) (1990) (amended 2002), and an "order" is "a written instruction to pay money signed by the person giving the instruction," *id.* § 3-103(a)(6) (1990) (amended 2002).

29. I eschew the formulation of "rights in the deposit account" to avoid ambiguity between rights of a person in a deposit entitlement (e.g., ownership interest or security interest) and rights arising out of the deposit account relationship, the depositor entitlement itself. For example, two customers on the same deposit account are co-owners of the deposit account. Their ownership interest is the co-tenancy interest. But each has rights arising out of the deposit account.

30. *See* U.C.C. § 9-102(a)(52) (defining a "lien creditor" as "a creditor that has acquired a lien on the property involved by attachment, levy, or the like"); *see, e.g.*, N.Y. C.P.L.R. § 5201(a) (MCKINNEY 2014) (providing that a "money judgment may be enforced against any debt, which is past due or which is yet to become due, certainly or upon demand of the judgment debtor"); FDIC v. Koffman, 849 F. Supp. 176, 177 (N.D.N.Y. 1994) (holding that

of the 2001 revision of Article 9 of the UCC, the customer can grant a security interest in the deposit entitlement to a secured party.

The customer may not easily assign a deposit entitlement directly in the same way the owner of an account can assign the account. Such an assignment typically requires amending the existing agreement or creating a new agreement with the bank. The practical limitation on assignability of a deposit entitlement may explain why the drafters of Article 9 designated the deposit account as a collateral type. This convention, however, does not negate the necessity to treat the deposit entitlement—and not the deposit account—as the property item. The value of the deposit entitlement derives not from its transferability but from the exercise of the exclusive rights by the owner of the deposit entitlement—the customer—to instruct the bank to dispose of the amount of funds credited to the deposit account.

As noted below in Part II.C, the operative provisions of several sections of Article 9, including Section 9-104 defining control of a deposit account[31] and Section 9-607 specifying the secured party's remedies upon default,[32] specifically refer to the secured party's ability to give instructions to the bank regarding the disposition or payment of funds credited to the deposit account. This language acknowledges the essence of the deposit account not as a property item but as a relationship between the customer and the bank in which the customer and the bank have certain rights and duties, including the obligation of the bank to direct the amounts credited to the deposit account in accordance with the customer's instructions and the deposit account agreement.[33]

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evidence that a checking account was held solely in name of judgment debtor was sufficient, under New York law, to support restraining notice served upon bank by judgment creditor restraining bank from transferring funds credited to judgment debtor's checking account).

31. U.C.C. § 9-104(a), *quoted infra* note 63.

32. *Id.* § 9-607(a)(4), (5), *quoted* in text accompanying note 67 *infra*.

33. A model deposit account control agreement reflects both Article 9's flawed definition of the deposit account and not the debtor's deposit entitlement as a property item subject to a security interest and the legal reality that the secured party has a security interest in the deposit entitlement—the right to direct the disposition of amounts credited to the deposit account. The model deposit account control agreement states:

> The undersigned, *[Name of Borrower]* (the "Borrower") is entering into a security agreement with *[Name of Secured Party]* ("Secured Party"). In furtherance of that security agreement, the undersigned, together with Secured Party, request that you [the Bank] enter into this agreement regarding the control of Account Number *[insert account number]*, which the Borrower maintains with you ("Deposit Account"). As part of the security agreement entered into between Borrower and Secured Party, the Borrower has agreed to grant the Secured Party a security interest in: (a) the *Deposit Account* . . . .

Because the term "deposit account" is not itself a property item, the appropriate property item that can be collateral for a security interest consists of the deposit entitlement. Accordingly, those sections of Article 9 providing for the creation, perfection, or priority of a security interest or other interests in a deposit account should be revised, and pending such revision, should be interpreted as referring to the creation, perfection, and priority of the security interest or other interest in the deposit entitlement arising out of an identified deposit account.[34]

For example, attachment of a security interest in a deposit account under Section 9-203 is actually attachment of a security interest to the debtor's deposit entitlement with respect to the amount of funds credited to a deposit account.[35] Section 9-203(b)(2)'s requirement that the debtor have rights in the collateral is satisfied if the debtor has rights in the deposit entitlement—that is, the debtor is the person that owns the deposit entitlement.[36] A lien creditor can obtain a lien only in the debtor's deposit entitlement to the amount of funds credited in the deposit account.[37] Attachment of a security interest as the result of control[38] pursuant to Section 9-104[39] and perfection of a security interest in the deposit account by control pursuant to Section 9-312,[40] Section 9-314,[41] and Section 9-104,[42] should be revised and interpreted as the perfection of a security interest in the deposit entitlement to amounts credited to the deposit account. The same revision and reinterpretation applies to the rules for the priority among conflicting interests in a deposit account set forth in Section

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> [T]he Borrower and Secured Party hereby agree that the Secured Party shall be entitled at any time to give you instructions as to the withdrawal or disposition of any funds from time to time *credited to the Deposit Account* . . . .

UNIF. COMMERCIAL CODE FORMS AND MATERIALS, 5 U.L.A. 652, 652, § 9.2.9.2, Form 1, Deposit Account Control Agreement (2001) (emphasis added).

34. In addition, when used to describe a type of collateral, "deposit entitlement" should replace "deposit account". *See* U.C.C. § 9-102(a)(42), *quoted supra* note 6 (definition of general intangible); *id.* § 9-102(a)(44) (definition of goods).

35. *Id.* § 9-203(b), *quoted supra* note 9.

36. *Id.* § 9-203(b)(2), *quoted supra* note 9.

37. *See* sources cited *supra* note 30.

38. *See* U.C.C. § 9-203(b)(3)(D), *quoted supra* note 9.

39. *Id.* § 9-104(a), *quoted infra* note 63.

40. *Id.* § 9-312(b)(1) (stating that, except in the case of proceeds, "a security interest in a deposit account may be perfected only by control under Section 9-314").

41. *Id.* § 9-314(a) (stating that a "security interest in investment property, deposit accounts, letter-of-credit rights, electronic chattel paper, or electronic documents may be perfected by control of the collateral under Section 7-106, 9-104, 9-105, 9-106, or 9-107").

42. *Id.* § 9-104(a), *quoted infra* note 63.

9-327.[43] The need for this revision and reinterpretation applies to a number of other sections in Article 9,[44] although in some sections the need for this revision and reinterpretation applies to some uses of the term "deposit account" but not to other uses in the same section.[45]

In particular, Section 9-332(b) requires revision and reinterpretation of the deposit account to mean deposit entitlement. This section provides that a "transferee of *funds from a deposit account* takes the funds free of a *security interest in the deposit account* unless the transferee acts in collusion with the debtor in violating the rights of the secured party."[46] In

43. *Id.* § 9-327, *quoted infra* note 68.

44. *See id.* § 9-109(d)(10) (exclusion from Article 9 of a right of recoupment or set-off except for effectiveness of rights of recoupment or set-off "against deposit accounts" under § 9-340); *id.* § 9-109(d)(13) (exclusion from Article 9 of "an assignment of a deposit account" in a consumer transaction except with respect to proceeds); *id.* § 9-109 cmt. 16 (generally referring to a deposit account as if it were the property item instead of the debtor's deposit entitlement with respect to the deposit account); *id.* § 9-310(b)(8) (providing that a financing statement need not be filed to perfect a security interest in deposit accounts perfected by control); *id.* § 9-316(f) (the effect of a change in the bank's jurisdiction upon perfection of a security interest in deposit accounts); *id.* § 9-340 (effectiveness of rights of recoupment or set-off against deposit accounts subject to a security interest).

Section 9-208(b)(2) presents a separate case for a slight revision. Subsection 9-208(b)(2) provides that, when there is no outstanding secured obligation and no obligation to give value, a secured party that has control of a deposit account as the bank's customer under Section 9-104(a)(3), *quoted infra* note 63, shall "(A) pay the debtor the balance on deposit in the deposit account; or (B) transfer the balance on deposit into a deposit account in the debtor's name." If the secured party is the customer, it actually cannot pay or transfer the balance; it must instead instruct the bank to pay or transfer the balance. Contrast this mistake with the provisions of Section 9-607(a)(5), *quoted in* text accompanying note 67 *infra*, which correctly refers to the secured party instructing the bank to pay the balance to the secured party.

45. *Compare id.* § 9-304(a) (providing that the local law of the bank's jurisdiction governs the perfection, effect of perfection or nonperfection and priority in a security interest in a deposit account maintained with that bank), *with id.* § 9-304(b) (providing a hierarchy of rules for determining the jurisdiction of the bank maintaining a deposit account by reference to the jurisdiction identified in the agreement between the bank and the customer governing the deposit account, the jurisdiction of the office of the bank identified in the account statement, or the jurisdiction of the chief executive office of the bank), *and id.* § 9-341 (providing that unless the bank otherwise agrees, "a bank's *rights and duties with respect to a deposit account* maintained with the bank are not terminated, suspended, or modified by: (1) the creation, attachment, or perfection of a *security interest in the deposit account*; (2) the bank's knowledge of the security interest; or (3) the bank's receipt of instructions from the secured party" (emphasis added)).

46. *Id.* § 9-332(b) (emphasis added).

Garner v. Knoll, Inc. (In re Tusa-Expo Holdings, Inc.),[47] the United States Court of Appeals for the Fifth Circuit misinterpreted this section in part because it relied on a notion of both a deposit account and the funds credited to the deposit account as things or property items. The Fifth Circuit held that a secured party with a perfected security interest in a deposit account continued to have a security interest in the funds transferred from the account to a third party transferee.[48] In so ruling, the court purported to rely on the "plain language" of Section 9-332(b).[49] The court concluded that this section meant only that a transferee took the funds free of the

47. 811 F.3d 786 (5th Cir. 2016).

48. *Id.* at 795-97. Tusa-Expo, a seller of furniture, had granted a security in its assets to two secured parties, Knoll, Inc., and Textron Financial, Inc. *Id.* at 790. Knoll, a manufacturer of furniture, had a first priority perfected security interest in certain accounts owned by Tusa-Expo and in the proceeds of those accounts, which included a deposit account to which customers sent payments on the accounts. *Id.* Textron had a second priority perfected security interest in the accounts and the deposit account and a first priority perfected security interest in Tusa-Expo's remaining assets. *Id.* Tusa-Expo was the customer on the deposit account, but the deposit account was subject to Textron's control. *Id.* Under the arrangement between Textron, Knoll, and Tusa-Expo, Textron withdrew the funds credited to the deposit account every day, applied the amount of such funds to reduce Textron's loan, and on request from Tusa-Expo, made new loans to Tusa-Expo by advancing the loan proceeds to Tusa-Expos's operating account. *Id.* Tusa-Expo used the proceeds of the loans to pay Knoll and other creditors. *Id.* In November 2008, Tusa-Expo became a debtor in bankruptcy, and in November 2010, the bankruptcy trustee sought to avoid approximately $4.6 million paid by Tusa-Expo to Knoll during the 90 days before the commencement of Tusa-Expo's bankruptcy case as preferential transfers. *Id.* The critical issue in the avoidance action was whether the source of the payments to Knoll was Knoll's collateral. *Id.* at 791-94. If so, the payments could not be avoided as a preferential transfer.

The court first concluded that Knoll had a perfected security interest in the deposit account and substantially all of the funds credited to the account. *Id.* at 795. If the funds credited to the deposit account had been paid directly to Knoll, the form of payment would have been proceeds of the deposit account and would have represented payments from Knoll's collateral. In that case, the payments would not have been avoided. Unfortunately, the funds in the deposit account were not paid to Knoll but to Textron. *Id.* For this reason, as the bankruptcy trustee argued, under Section 9-332(b), Textron as the transferee received those funds free of Knoll's security interest and the security interest in the deposit account did not extend to the funds paid to Textron. *Id.* When Textron later loaned funds to Tusa-Expo and Tusa-Expo paid those funds to Knoll, those payments did not come from Knoll's collateral. The court of appeals, however, erroneously held the funds remained subject to the security interest when they passed through Textron back to Tusa-Expo and then to Knoll, that the source of the pre-petition payments of $4.6 million was Knoll's collateral, and therefore the pre-petition payments were not recoverable as preferential transfers. *Id.* at 801.

49. *Id.* at 795 (quoting the "plain language of" the subsection); *id.* at 797 (stating that the "plain language of § 9.332(b) is unambiguous").

security interest in the deposit account but not in the funds. The court also apparently believed that a security interest in a deposit account gave the secured party a security interest in the funds in the account.

The court reasoned that Section 9-332(b) was similar, but not identical to, Section 9-332(a), which provides that a non-colluding "transferee of money takes the money free of a security interest."[50] The court stated, "[t]his difference must have been intentional."[51] The court stated that Section 9–322(b) could have provided that the transferee takes the funds free of any security interest, as does Section 9-322(a), or takes the funds from a security interest in the funds.[52] The court also stated that Section 9-332(b) "does not even address, much less strip, a security interest that encumbers the funds contained in the deposit account" and does not protect the transferee "from [the debtor's] first-priority security interest in the funds contained in [the deposit] account."[53]

This discussion reveals a profound misunderstanding of a deposit account. The language of Article 9 designating a deposit account, a contractual relationship, as an item of collateral instead of the deposit entitlement—that is, the customer's rights arising from this relationship—makes it harder to dispel the misunderstanding.

First, the difference between the wording in subsection (a) and subsection (b) is of course intentional because there is a profound difference between money and a deposit account. Money is a tangible item in which a person can have a security interest. With certain exceptions, a secured party's security interest in collateral continues in the hands of a transferee notwithstanding disposition.[54] Section 9-332(a) is an exception: A non-colluding transferee of collateral in the form of money takes it free of the original security interest.

A deposit account is different. A deposit account as collateral is really the intangible deposit entitlement, and the funds "in" the deposit account do not actually exist as a property item. The funds are just a book-entry indication of the balance that the bank is obligated to pay upon the direction of the customer. When the debtor as the customer directs disposition to a

50. U.C.C. § 9-332(a).

51. *Garner*, 811 F.3d at 795.

52. *Id.* at 795-96.

53. *Id.* at 796.

54. *See* U.C.C. § 9-315(a)(1) (stating that except as otherwise provided in Article 9, "a security interest . . . continues in collateral notwithstanding sale, lease, license, exchange, or other disposition thereof unless the secured party authorized the disposition free of the security interest").

transferee of an amount of funds credited to the deposit account, its property interest—the deposit entitlement to that amount—ends to that extent (even though the deposit account itself continues to exist until it is closed). The customer no longer has the right to direct disposition of that amount of funds. Under Section 9-315(a)(2), however, a security interest in collateral—nominally, the deposit account, but in legal reality the deposit entitlement—continues in identifiable proceeds.[55] The purpose of Section 9-322(b) is to create an exception to this normal rule.

For example, when a debtor that is the customer directs the payment of $100 credited to its deposit account to a transferee, the transferee receives and holds an amount of funds equal to $100 in the form of some type of Article 9 collateral. For example, if the debtor writes a check to the transferee for $100 and the transferee cashes the check, the $100 debited from the customer's deposit account becomes money held by the transferee. If the transferee deposits the check into its own deposit account and the check clears the debtor's deposit account, the $100 is evidenced by an increased credit balance in the transferee's deposit account. Whatever the form, the amount of those funds, embodied in some type of property item, are proceeds of the debtor's depositor entitlement. As noted above, once the bank pays an amount of funds equal to $100 credited the debtor's deposit account, the debtor no longer has any right to direct the payment of that $100 of funds, and the secured party security interest in that right would end. The secured party would only have a security interest in the proceeds of that right to the $100 debited from the deposit account. Section 9-339(b), however, is designed to cut off the security interest in the amount of funds received by the transferee that are proceeds of the deposit entitlement to the $100 previously credited to the debtor's deposit account.

The reference in Section 9-332(b) to a security interest in a deposit account is not the main source of the Fifth Circuit's error. The court erred because it did not understand the nature and workings of a deposit account. A reference, however, to a security interest in the deposit entitlement, which after all entitles the debtor to dispose of funds credited to the deposit account, would make it easier to educate those not familiar with deposit accounts. The best statutes regulating property interests and transactions are those whose language reflects the nature of the property item and the

55. *See id.* § 9-315(a)(2), *quoted infra* note 56; *see also id.* § 9-315(b), *quoted infra* note 60 and discussed in accompanying text (permitting identification of commingled proceeds); *id.* § 9-102(a)(64) (defining proceeds to include that which is distributed on collateral), *quoted infra* note 59.

transactions. The term "deposit entitlement" as a collateral type meets this test. The term "deposit account" as a collateral type does not.

B. The Deposit Entitlement to Identifiable Cash Proceeds

Proceeds of collateral in the form of a deposit account present a particularly important instance for revising and interpreting the term "deposit account" to mean the deposit entitlement to specific amounts of funds credited to the deposit account. Assume that a secured party has a security interest in collateral—whether it be goods or a receivable like an account—perfected by the filing of a financing statement. Assume that the debtor receives a check in the amount of $1000 from the sale of the collateral or, in the case of a receivable, as a collection of the receivable, and in either case, deposits the check into the debtor's general checking account. Also assume that before the deposit, there was $2000 already credited to the debtor's checking account that is not subject to the interest of any person other than the customer or the bank, including a security interest. After the $1000 proceeds check clears, there is $3000 credited to the account. The secured party should continue to have a perfected security interest with respect to $1000 of this amount.

Sections 9-315 purports to provide such a perfected security interest. A security interest in collateral continues in identifiable proceeds of the collateral.[56] Under Section 9-315(d)(2), the secured party has a continuously perfected security interest in identifiable cash proceeds.[57] By definition,[58] cash proceeds include a deposit account. The check for $1000 was proceeds of the original collateral, and under the terms of Article 9 the deposit account is proceeds of the check.[59] The security interest in the

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56. *See id.* § 9-315(a)(2) ("[A] security interest attaches to any identifiable proceeds of collateral.").

57. Subsections § 9-315(c) and (d) state:

> (c) . . . A security interest in proceeds is a perfected security interest if the security interest in the original collateral was perfected.
>
> (d) . . . A perfected security interest in proceeds becomes unperfected on the 21st day after the security interest attaches to the proceeds unless:
>
> . . . .
>
> (2) the proceeds are identifiable cash proceeds . . . .

Id. § 9-315(c), (d).

58. *See id.* § 9-102(a)(9) (defining "cash proceeds" as "proceeds that are money, checks, deposit accounts, or the like").

59. *See id.* § 9-102(a)(64) (stating that "proceeds", except as used in Section 9-609(b), "means the following property: (A) whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral; [or] (B) whatever is collected on, or distributed

deposit account as cash proceeds will continue so long as the cash proceeds are identifiable. The cash proceeds are identifiable so long as they can be traced by the lowest intermediate balance tracing rule.[60]

The literal wording of these provisions, however, does not work. The cash proceeds in this example do not consist of the deposit account. The cash proceeds consist of the debtor's deposit entitlement to some portion of the funds credited to the deposit account. The debtor as the customer of the checking account has a deposit entitlement to all $3000 credited to the deposit account. The secured party, however, has a perfected security interest only in the debtor's deposit entitlement to $1000 credited to that account.[61] Under the lowest intermediate balance rule,[62] if the debtor causes the bank to withdraw and debit $1200 from the checking account, reducing the balance to $1800, the secured party continues to have a perfected security interest in the deposit entitlement to $1000 credited to the checking account. If the debtor causes the withdrawal or debit of another $1100 from the checking account, reducing the balance to $700, the secured party has a perfected security interest in the debtor's deposit entitlement to the remaining $700 credited to the checking account.

In conclusion, to apply Article 9's rules to proceeds that consist of a deposit account, an intelligible and correct revision and interpretation of these sections requires identification of the extent of the debtor's deposit entitlement to a specified amount of funds credited to the deposit account. The term "deposit account" should be revised to read and, pending such revision, must be interpreted to mean the debtor's deposit entitlement to the amounts credited to the deposit account that are traceable as proceeds of collateral.

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on account of, collateral"); *id.* § 9-102(a)(12)(A) (stating that "collateral" includes "proceeds to which a security interest attaches").

60. *See id.* § 9-315(b) ("Proceeds that are commingled with other property are identifiable proceeds: . . . if the proceeds are not goods, to the extent that the secured party identifies the proceeds by a method of tracing, including application of equitable principles, that is permitted under law other than this article with respect to commingled property of the type involved."); *see also id.* § 9-315 cmt. 3 (referencing the lowest intermediate balance rule as one of the methods that equitable principles would allow, and referring to the RESTATEMENT (SECOND) OF TRUSTS § 202 (AM. LAW INST. 1959)); Markell, *supra* note 19, at 971-72.

61. *See* RESTATEMENT (SECOND) OF TRUSTS § 202 (AM. LAW INST. 1959).

62. *See* Turley v. Mahan & Rowsey, Inc. (*In re* Mahan & Rowsey, Inc.), 817 F.2d 682, 684-85 (10th Cir. 1987) (describing and applying the lowest intermediate balance rule); *see also* Tex. Comptroller of Pub. Accounts v. Weathers (*In re* Vaughn Motors, Inc.), No. 00-50358, 2001 WL 85918 at *3 (5th Cir. Jan. 25, 2001) (same).

C. Appropriate Use of the Term "Deposit Account"

Other sections and comments of Article 9 correctly use the term "deposit account" to refer to the relationship between the bank and the customer. These usages reinforce the main point: The collateral is not the deposit account but the deposit entitlement to the amount of funds credited to the deposit account.

For example, Section 9-104's definition of "control" of a deposit account uses the term "deposit account" correctly without the necessity for supplying a missing "deposit entitlement" arising out of the deposit account.[63] Paragraphs (1) and (3) of Section 9-104(a) provide that a secured party has control if the secured party is the "bank with which the deposit account is maintained" or "the secured party becomes the bank's customer with respect to the deposit account."[64] Under Section 9-104(a)(2), a secured party can obtain control of the deposit account if the bank agrees to "comply with *instructions* originated by the secured party *directing disposition of the funds* in the deposit account."[65] Further, Section 9-104(b) states, "A secured party that has satisfied subsection (a) has control, even if the debtor retains *the right to direct the disposition of funds* from the deposit account."[66]

The language of this section expressly recognizes that as collateral, the deposit account *actually* consists of the deposit entitlement to the amount of funds credited to the deposit account, and not the deposit account itself. Section 9-104(a)(2) and Section 9-104(b) reveal that the collateral is actually the right to direct disposition of funds credited to the deposit account. Neither the amount of funds credited to the deposit account nor the deposit account constitute a property item that can be owned and therefore can constitute collateral subject to a security interest. Only the deposit

63. Section 9-104(a) states:

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

U.C.C. § 9-104(a).

64. *Id.* § 9-104(a)(1), (3).

65. *Id.* § 9-104(a)(2) (emphasis added).

66. *Id.* § 9-104(b) (emphasis added).

entitlement is a property item that can be owned or subjected to a security interest.

The reference in the definitions of control to the disposition of funds "in" or "from" the deposit account is somewhat problematic. Although the bank has funds that it can transfer by various means, the amount of funds credited to a deposit account are not actually "in" the deposit account and are not transferred "from" the account. The use of the terms "in" and "from" the deposit account, though common, are misleading because they suggest a custodial, instead of a debtor-creditor, relationship between the bank and the customer. This language requires the person reading and applying the statutory provisions governing deposit accounts to work harder to understand what is actually happening. Nevertheless, realizing or remembering that the funds credited to a deposit account are not actually "in" the deposit account and interpreting the phrase "deposit account" to mean, where appropriate, the debtor's deposit entitlement to the amounts credited to the deposit account will allow the correct interpretation of the deposit account attachment, perfection, and priority rules.

The sections within Article 9 that specify a secured party's remedies upon the debtor's default do not include the problematic reference to a security interest in the deposit account, reflecting the actual meaning of the term "deposit account." Section 9-607(a) states:

> If so agreed, and in any event after default, a secured party:
>
> . . . .
>
> (4) if it holds a security interest in a deposit account perfected by control under Section 9-104(a)(1) [i.e., the bank is the secured party], may apply the *balance of the deposit account* to the obligation secured by the deposit account; and
>
> (5) if it holds a security interest in a deposit account perfected by control under Section 9-104(a)(2) or (3) [the parties entered into a control agreement or the secured party becomes the customer], may *instruct* the bank to pay the *balance of the deposit account* to or for the benefit of the secured party.[67]

67. *Id.* § 9-607(a)(4), (5) (emphasis added).

These references to the bank applying or paying the balance of the deposit account reflect the reality that the true collateral consists of the deposit entitlement to the amounts credited to the deposit account.

Section 9-327 governs priority of security interests in the deposit entitlement. Although this section refers to security interests "in the deposit account" and control "of the deposit account," it contains several references to "the bank with which the deposit account is maintained."[68] Other sections and comments also use the term "deposit account" correctly.[69]

In other sections, reference to the term "deposit account" suffices even though the actual collateral is the debtor's deposit entitlement to the funds credited to a deposit account. For example, Section 9-203(b)(3)(A) provides one alternative method for satisfying one of the requirements for attachment of a security interest in collateral consisting of deposit accounts: authentication of security agreement identifying the collateral.[70] Although the collateral is actually the deposit entitlement to the funds credited to the deposit account, identification of the deposit account could sufficiently describe the debtor's deposit entitlement to the funds credited to the deposit account; since, by definition, the deposit entitlement only exists if there is a deposit account that is the subject of a deposit account agreement with a

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68. Section 9-327 states:

> The following rules govern priority among conflicting security interests in the same deposit account:
>
> (1) A security interest held by a secured party having control of the deposit account under Section 9-104 has priority over a conflicting security interest held by a secured party that does not have control.
>
> (2) Except as otherwise provided in paragraphs (3) and (4), security interests perfected by control under Section 9-314 rank according to priority in time of obtaining control.
>
> (3) Except as otherwise provided in paragraph (4), a security interest held by *the bank with which the deposit account is maintained* has priority over a conflicting security interest held by another secured party.
>
> (4) A security interest perfected by control under Section 9-104(a)(3) has priority over a security interest held by *the bank with which the deposit account is maintained*.

Id. § 9-327 (emphasis added).

69. *Id.* § 9-304(b) (providing a hierarchy of rules for determining the jurisdiction of the bank maintaining a deposit account by reference to the jurisdiction identified in the agreement between the bank and the customer governing the deposit account, the jurisdiction of the office of the bank identified in the account statement, or the jurisdiction of the chief executory office of the bank); *see also id.* § 9-102 cmt. 5(a) (noting that when a bank-lender "credits a borrower's deposit account" for the amount of a loan, the bank's advance is not an "account").

70. *See id.* § 9-203(b)(3)(A), *quoted supra* note 9.

bank.[71] Although other provisions require revision or interpretation of the term "deposit account" to mean "deposit entitlement," an express rule here—stating that identification of a deposit account constitutes identification of the deposit entitlement to funds credited to that deposit account—may be advisable but may not be necessary.

III. Securities Account: Redundancy and Error

A securities account is one of the subtypes of the collateral type, investment property. The other subtypes of investment property are securities and security entitlements, which are property items in which a person can have an ownership interest or a security interest, and commodity accounts and commodity contracts, which are analyzed in Part IV below. It was a mistake to include securities account as a subtype of investment property, and the provisions governing security interests in securities accounts contain errors that should be corrected. These topics are analyzed in Subparts B through E below. To provide the background for the analysis presented in these subparts, the following Subpart A describes the structure of the indirect holding system for securities that relies on security entitlements in financial assets credited to a securities account.

A. Securities Accounts and the Indirect Holding System for Securities

Issuers issue securities[72] that are either certificated securities—evidenced by a certificate[73]—or uncertificated securities evidenced not by a certificate

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71. *See id.* § 9-108(a) (stating that, with exceptions not relevant here, "a description of personal or real property is sufficient, whether or not it is specific, if it reasonably identifies what is described"); *id.* § 9-108(b) (stating that "a description of collateral reasonably identifies the collateral if it identifies the collateral by . . . (3) except as otherwise provided in subsection (e), a type of collateral defined in" the UCC).

72. Section 8-102(a)(15) defines "security":

> "Security," except as otherwise provided in Section 8-103, means an obligation of an issuer or a share, participation, or other interest in an issuer or in property or an enterprise of an issuer:
>
> (i) which is represented by a security certificate in bearer or registered form, or the transfer of which may be registered upon books maintained for that purpose by or on behalf of the issuer;
>
> (ii) which is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations; and
>
> (iii) which:
>
> (A) is, or is of a type, dealt in or traded on securities exchanges or securities markets; or
>
> (B) is a medium for investment and by its terms expressly provides that it is a security governed by this Article.

but by book entry on the books of the issuer.[74] With the exception of mutual funds, which are generally issued in the form of uncertificated securities,[75] most investors invest in securities not by acquiring securities but by acquiring security entitlements directly or indirectly in the securities through one or more securities intermediaries that maintain securities accounts for the investors.[76] Indeed, in most cases, the investor does not have a security entitlement in a security but has a security entitlement in a security entitlement in a security or another security entitlement. As described below, there are normally at least two tiers of security entitlements, and there can be many more.

The term "securities account" and "security entitlement" originated in the 1994 revision of Article 8 of the UCC that replaced the 1977 revision of Article 8.[77] This revision modernized the law governing interests in securities held through the book-entry system. It also added two new sections to former Article 9, Sections 9-115 and 9-116, which set forth rules for the creation, perfection, and priority of security interests in security entitlements and securities accounts.[78] As part of the 2001 revision of Article 9, these provisions were reallocated to the appropriate sections of the revised Article 9.[79]

Id. § 8-102(a)(15).

73. *See id.* § 8-102(a)(16) (defining "certificate").

74. *See id.* § 8-102(a)(18); *id.* § 8-301(b) (providing that "[d]elivery of an uncertificated security to a purchaser occurs when: (1) the issuer registers the purchaser as the registered owner, upon original issue or registration of transfer").

75. *See* UNIF. COMMERCIAL CODE, art. 8, pref. note, part I.B (1994), 2C U.L.A. 432 (2005); *id.* part III.C.6, 2C U.L.A. 444 (stating that "mutual fund shares are typically uncertificated securities under Article 8"); SEC. & EXCH. COMM'N, MUTUAL FUNDS: A GUIDE FOR INVESTORS 5 (2007) (noting that investors purchase mutual funds shares from the mutual fund itself).

76. *See generally* UNIF. COMMERCIAL CODE, art. 8, pref. note, part I.C, 2C U.L.A. 432-33.

77. *See generally id.* art. 8, pref. note, part I, 2C U.L.A. 431-34; Charles W. Mooney, Jr., *Beyond Negotiability: A New Model for Transfer and Pledge of Interests in Securities Controlled by Intermediaries*, 12 CARDOZO L. REV. 305, 307-10, 316-24 (1990) (describing the indirect holding system in the 1980s).

78. *See* U.C.C. §§ 9-115, 9-116 (1994) (superseded 2001, as amended 2010).

79. *See* U.C.C. § 9-102 cmt. 6, para. 1 (2010).

The 1994 revision of Article 8 and introduction of the term "security entitlement" represent a well-executed, if somewhat belated, creation of a legal regime that accurately reflected the transition of the securities market from one that relied almost exclusively on the issuance and holding of security certificates in the 1960s to the current system in which most securities are held in book-entry form as security entitlements. Only a small percentage of investors will directly hold securities in the form of a security certificate.

In many cases, an issuer will issue a security in the form of a certificated security or an uncertificated security directly to the Depository Trust Company ("DTC"). DTC acts as a "securities intermediary" and credits the security to an account (a "securities account") that it maintains on behalf of a participant in DTC (a "Participant").[80] The Participant, which may be an investment bank or a commercial bank (the "entitlement holder"), holds a "security entitlement" in the underlying security, which is a "financial asset" credited to the securities account. Thereafter, any purchasers of the securities are in fact purchasing not securities but security entitlements in financial assets credited by securities intermediaries to the entitlement holder's securities account through a multi-tiered, indirect holding system. Article 8 creates the legal regime governing this multi-tiered, indirect holding system through several key definitions.

A "securities account" is

> an account to which a financial asset is or may be credited in accordance with an agreement under which the person maintaining the account [the securities intermediary] undertakes to treat the person for whom the account is maintained [the entitlement holder] as entitled to exercise the rights that comprise the financial asset."[81]

A "security entitlement" consists of "the rights and property interest of an entitlement holder with respect to a financial asset specified in Part 5 [of Article 9 of the UCC]."[82] The person that has these rights is the

80. *See generally* UNIF. COMMERCIAL CODE art. 8, pref. note, part I.C, 2C U.L.A. 432-33.

81. U.C.C. § 8-501(a).

82. *Id.* § 8-102(a)(17).

"entitlement holder,"[83] and the person maintaining the securities account is the "securities intermediary."[84]

A "financial asset" is either a "security" or "any property that is held by a securities intermediary for another person in a securities account if the securities intermediary has expressly agreed with the other person that the property is to be treated as a financial asset under this Article."[85] The term "any property" includes a security entitlement. This point is confirmed by the remainder of the definition of financial asset, which states that "the term [financial asset] means either the interest itself or the means by which a person's claim to it is evidenced, including a certificated or uncertificated security, a security certificate, or a *security entitlement.*"[86]

Accordingly, in the case of a security issued to DTC, DTC, the securities intermediary, holds the security, which is a financial asset, that it has credited to the securities account for the Participant. The Participant has a security entitlement in the financial asset, the security, and therefore becomes an entitlement holder. The Participant could credit this security entitlement to another securities account that it maintains for its customers. Its customers may be other securities brokers or the ultimate investor.[87]

The following example, Example 1, illustrates an investment through the indirect holding system by an investor, Investor *A*, in 10,000 shares of *XYZ* Company out of a total issuance of 100,000 shares issued by *XYZ*. *XYZ* issues a certificated or uncertificated security to DTC. DTC creates a securities account for Participant, and DTC credits the security evidencing the 100,000 shares of *XYZ* to Participant's securities account. Participant, thereby, acquires a security entitlement in the 100,000 shares and becomes the entitlement holder of this security entitlement.

Participant then sells 50,000 shares of *XYZ* to Regional Broker *A*, for whom Participant has previously created or will create a securities account. Participant credits Participant's security entitlement for 50,000 shares (out of Participant's security entitlement for 100,000 shares) to Regional Broker *A*'s securities account. Regional Broker *A*, thereby, becomes the entitlement

83. *See id.* § 8-102(a)(7) (defining "entitlement holder" as "a person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary").

84. *See id.* § 8-102(a)(14) (defining "securities intermediary" as "(i) a clearing corporation; or (ii) a 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").

85. *Id.* § 8-102(a)(9).

86. *Id.* (emphasis added).

87. *See generally* UNIF. COMMERCIAL CODE art. 8, pref. note, part I.B (1994), 2C U.L.A. 432-33 (2005).

holder of a security entitlement in a financial asset consisting of Participant's security entitlement in 50,000 shares of *XYZ*.

Finally, Regional Broker *A* then sells 10,000 shares of *XYZ* to Investor *A*, for whom Regional Broker *A* has previously created or will create a securities account. Regional Broker *A* credits Regional Broker's security entitlement for 10,000 shares (out of its security entitlement for 50,000 shares) to Investor *A*'s securities account. Investor *A*, thereby, acquires as entitlement holder a security entitlement in a financial asset consisting of Regional Broker *A*'s security entitlement in 10,000 shares of XYZ.[88]

The following Table 1 presents this example of Investor *A*'s investment through the indirect holding system from the issuer's perspective:

Example 1: Table 1

	INITIATING ENTITY	RECIPIENT ENTITY
1.	*XYZ* issues a security evidencing 100,000 shares to DTC.	DTC is registered owner of security.
2.	DTC credits security evidencing 100,000 shares to Participant's securities account created by DTC. DTC = securities intermediary for Participant.	Participant is entitlement holder of security entitlement in 100,000 shares.
3.	Participant sells 50,000 shares to Regional Broker *A*. Participant credits its security entitlement in 50,000 shares to securities account of Regional Broker *A*. Participant = securities intermediary for Regional Broker *A*.	Regional Broker *A* is entitlement holder of security entitlement in 50,000 shares.
4.	Regional Broker *A* sells 10,000 shares to Investor *A*. Regional Broker *A* credits security entitlement in 10,000 shares to securities account of Investor *A*. Regional Broker *A* = securities intermediary for Investor *A*.	Investor *A* is entitlement holder of security entitlement in 10,000 shares.

88. As following material shows, Investor *A* will acquire (1) a security entitlement in (2) Regional Broker *A*'s security entitlement for 10,000 shares in (3) Participant's security entitlement in (4) DTC's security.

The following Table 2 presents this example of Investor *A*'s investment through the indirect holding system from the investor's perspective:

Example 1: Table 2

	PURCHASER/ ENTITLEMENT HOLDER	FORM OF INVESTMENT PROPERTY	SECURITIES INTERMEDIARY FOR ENTITLEMENT HOLDER	UNDERLYING FINANCIAL ASSET
1.	Investor *A* = entitlement holder	Security entitlement in 10,000 shares	Regional Broker *A* for Investor *A*'s securities account	Regional Broker *A*'s security entitlement in 10,000 shares
2.	Regional Broker *A* = entitlement holder	Security entitlement for 50,000 shares (of which 10,000 shares is credited to Investor *A*)[89]	Participant for Regional Broker *A*'s securities account	Participant's security entitlement in 50,000 shares (out of total security entitlement for 100,000 shares)
3.	Participant = entitlement holder	Security entitlement for 100,000 shares (of which 50,000 shares is credited to Regional Broker *A*)	DTC for Participant's securities account	DTC's security for 100,000 shares
4.	DTC = registered owner	100,000 shares in the form of a security	Not applicable	Not applicable

89. I describe the underlying financial asset as the Regional Broker's security entitlement for the full 50,000 shares because the portion reflecting 10,000 shares is not segregated. If Regional Broker *A* had created security entitlements for 10,000 shares for each of ten investors (mistakenly or fraudulently) for a total of 100,000 shares, then each investor, such as Investor *A*, only has a security entitlement in a pro-rata share (50%) of the actual underlying security entitlement for 50,000 shares, or a security entitlement in 5000 shares. *See* U.C.C. § 8-503(b) (providing that an "entitlement holder's property interest with respect to a particular financial asset [held by the securities intermediary] under subsection (a) is a pro rata property interest in all interests in that financial asset held by the securities intermediary, without regard to the time the entitlement holder acquired the security entitlement or the time the securities intermediary acquired the interest in that financial asset").

The following figure also illustrates the tier of financial assets underlying Investors *A*'s security entitlement.

Example 1: Figure 1

Issuer - - - >	DTC - - - >	Participant - - - >	Reg. Broker *A* - - - >	Inv. *A*
	security	sec. ent.	sec. ent.	sec. ent.
	100,000 sh.	100,000 sh.	50,000 sh.	10,000 sh.

If Investor *A* wanted to engage a custodian to maintain all of its investment property, Investor *A* would simply create another tier of security entitlement. Regional Broker *A*, Investor *A* and the custodian would take the following steps: Initially, Regional Broker *A* would create a securities account for the custodian and would credit its security entitlement for 10,000 shares to the new securities account that it maintains for the custodian. The custodian would thereby acquire as the entitlement holder a security entitlement in financial assets consisting of Regional Broker *A*'s security entitlement for 10,000 shares. At the same time, custodian would create a securities account for Investor *A* and would credit the custodian's newly acquired security entitlement for 10,000 shares to the new securities account that the custodian maintains for Investor *A*. Investor *A* would thereby acquire as the entitlement holder a security entitlement in financial assets consisting of the custodian's security entitlement in Regional Broker *A*'s security entitlement for 10,000 shares. The ability to create additional security entitlements gives investors flexibility in structuring securities and financing transactions.

Securities issued by the United States government follow a similar book-entry structure. Investors in debt securities of the United States government do not receive the securities but instead receive security entitlements through one or more tiers of security entitlements in the debt securities issued by the Department of the Treasury through the federal commercial book-entry system, the regulations for which are referred to as the "Treasury/Reserve Automated Debt Entry System (TRADES)."[90] Under the

90. *See* 31 C.F.R. pt. 357, subpts. A, B (2015) (Treasury bills, notes and bonds); U.S. Dep't of Treasury Bureau of Fiscal Serv., *Commercial Book Entry System*, TREASURY DIRECT, http://www.treasurydirect.gov/instit/auctfund/held/cbes/cbes.htm (last visited June 3, 2017); *see also* 12 C.F.R. pt. 615, subpts. O, S (governing book-entry securities of the Farm Credit Administration); *id.* pt. 987 (governing book-entry securities of the Federal Home Loan Banks); *id.* pt. 1511 (governing book-entry securities of the Resolution Funding Corporation); 18 C.F.R. pt. 1314 (2015) (governing book-entry securities of the Tennessee

TRADES regulations, U.S. Treasury debt securities are issued to a federal reserve bank as uncertificated securities, evidenced not by a security certificate but by book entry on the books of the U.S. Treasury Department.[91] The federal reserve bank maintains securities accounts for participants, who have a security entitlement in the U.S. Treasury securities credited to the participant's account.[92] Each participant in turn typically credits its security entitlement in the securities held by the federal reserve bank to the securities accounts that it maintains for its investors. An investor in U.S. Treasury securities acquires a security entitlement evidencing the quantity of the investor's investment, such as a security entitlement for $100,000 in a five-year U.S. Treasury note, that will follow the same tiered structure as the security entitlement of Investor *A* in 10,000 shares of *XYZ*.

B. Elimination of the Securities Account Subtype

As described above, the term "security entitlement" defined in Article 8 of the UCC[93] (which would also include the comparable term defined in the federal TRADES regulations[94]) means the rights of the entitlement holder in the financial assets credited to a securities account maintained by the securities intermediary for the entitlement holder. As this definition and the definition of securities account shows, a securities account is a contractual relationship between the entitlement holder and the securities intermediary pursuant to which the entitlement holder and the securities intermediary have certain rights and duties regarding the financial assets credited to the

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Valley Authority); 24 C.F.R. pt. 81, subpt. H (2015) (governing book-entry securities of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation); *id.* pt. 350 (governing book-entry securities of the Government National Mortgage Association); 31 C.F.R. pt. 354 (2015) (governing book-entry securities of the Student Loan Marketing Association).

91. *See* 31 C.F.R. § 357.0(a)(1) (2015) (describing the commercial book-entry system); *id.* § 357.2 (defining "Book-entry Security" to include a "Treasury security maintained as a computer record in the commercial book-entry system"; Entitlement Holder" to mean "a Person to whose account an interest in a Book-entry Security is credited on the records of a Securities Intermediary"; "Participant" to mean "a Person that maintains a Participant's Securities Account with a Federal Reserve Bank"; "Participant's Securities Account" to mean "an account in the name of a Participant at a Federal Reserve Bank to which Book-entry Securities held for a Participant are or may be credited"; "Security Entitlement" to mean "the rights and property interest of an Entitlement Holder with respect to a Book-entry Security"; and "Securities Intermediary" to include a Federal Reserve Bank).

92. *See id.* § 357.12 (describing a participant's security entitlement).

93. *See* U.C.C. § 8-102(a)(17), *quoted in* text accompanying note 82 *supra*.

94. *See* 31 C.F.R. § 357.2, *supra* note 91 (defining "security entitlement").

securities account. As such, a securities account, like a deposit account and a commodity account, is not a property item in which a person may have a property interest. Again, only the rights that arise from this relationship can be property items.

Articles 8 and 9 already supply the defined term for these rights arising out of the securities account, the "security entitlement." The security entitlement is the property item in which a debtor can create and perfect, and a secured party can enforce, a security interest. Therefore, unlike a deposit account or a commodity account, there is no need implicitly to supplement the Article 9 rules for the creation, perfection, priority, or enforcement of a security interest in a securities account.

For example, if a person has rights in a security entitlement in the financial assets credited to the securities accounts sufficient for attachment of a security interest under Section 9-203(b), a secured party can obtain a security interest in those rights.[95] The secured party can perfect a security interest in the security entitlement pursuant to Section 9-312 because that section permits perfection by filing for investment property, which includes a security entitlement.[96] The secured party can also perfect a security interest in a security entitlement by control pursuant to Section 9-314,[97] Section 9-106,[98] and Section 8-106(d).[99]

Unlike a deposit account, Article 9 does not contain any specific provision for enforcing a security interest in a security entitlement or a securities account. Nevertheless, after default, under Section 9-607, a secured party can exercise the debtor's rights in collateral against the

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95. More than one person can have rights in a security entitlement, such as two co-owners. One co-owner can grant a security interest in that person's co-ownership interest in the security entitlement.

96. *See* U.C.C. § 9-312(a) (stating that a "security interest in chattel paper, negotiable documents, instruments, or investment property may be perfected by filing").

97. *See id.* § 9-314(a), *quoted supra* note 41.

98. *See id.* § 9-106(a) (stating that a "person has control of a certificated security, uncertificated security, or security entitlement as provided in Section 8-106").

99. Section 8-106(d) states:

> A purchaser has "control" of a security entitlement if:
>
> (1) the purchaser becomes the entitlement holder;
>
> (2) the securities intermediary has agreed that it will comply with entitlement orders originated by the purchaser without further consent by the entitlement holder; or
>
> (3) another person has control of the security entitlement on behalf of the purchaser or, having previously acquired control of the security entitlement, acknowledges that it has control on behalf of the purchaser.

Id. § 8-106(d).

person obligated on the collateral.[100] For collateral consisting of security entitlements, the secured party can exercise the debtor's rights against the securities intermediary as the person obligated on the security entitlement.[101]

Further, under Section 9-610, a secured party can dispose of collateral.[102] The secured party could dispose of the security entitlements in a commercially reasonable sale and effect that sale to a purchaser by directing the securities intermediary to transfer the financial assets to the purchaser as the purchaser directs. The mode of transfer would depend on the nature of the underlying financial assets. In addition, a secured party could exercise its rights under Section 9-607 and instruct the securities

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100. Section 9-607(a) states:

> If so agreed, and in any event after default, a secured party:
>
> (1) may notify an account debtor or other person obligated on collateral to make payment or otherwise render performance to or for the benefit of the secured party;
>
> (2) may take any proceeds to which the secured party is entitled under Section 9-315;
>
> (3) may enforce the obligations of an account debtor or other person obligated on collateral and exercise the rights of the debtor with respect to the obligation of the account debtor or other person obligated on collateral to make payment or otherwise render performance to the debtor, and with respect to any property that secures the obligations of the account debtor or other person obligated on the collateral . . . .

Id. § 9-607(a).

101. Under UCC Section 8-104, when a person acquires a security entitlement, it also acquires an interest in the financial asset credited to a securities account, which interest is limited by the provisions of Part 5 of Article 8 on security entitlements:

> (a) A person acquires a security or an interest therein, under this Article, if:
>
> . . . .
>
> (2) the person acquires a security entitlement to the security pursuant to Section 8-501.
>
> (b) A person acquires a financial asset, other than a security, or an interest therein, under this Article, if the person acquires a security entitlement to the financial asset.
>
> (c) A person who acquires a security entitlement to a security or other financial asset has the rights specified in Part 5, but is a purchaser of any security, security entitlement, or other financial asset held by the securities intermediary only to the extent provided in Section 8-503.

Id. § 8-104; *see also id.* §§ 8-503 through 8-508 (describing the duties of the securities intermediary to the entitlement holder and the limits on the rights of the entitlement holder).

102. *See id.* § 9-610(a) (stating that, after default, "a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing").

intermediary to sell the financial assets underlying the security entitlement. A reasonable interpretation of Section 9-610 on disposition of collateral would require that the securities intermediary also conduct, or that the secured party instruct the securities intermediary to conduct, a commercially reasonable sale complying with Section 9-610 and related sections. To avoid ambiguity, it would be advisable to amend the Article 9 default provisions to spell out the various methods for enforcing the secured party's security interest in security entitlements comparable to, but more detailed than, the two specific remedies for enforcing a security interest in a deposit account set forth in Sections 9-607(a)(4) and (5).[103]

Article 9's inclusion of securities account as a subtype of collateral presents a different story. Unquestionably, the concept of a securities account is a critical component of a security entitlement and the legal regime regulating the indirect holding system for securities. But Article 9's designation of a security entitlement as a subtype of collateral eliminates any need for including securities account as a subtype of collateral.

Comment 6 to Section 9-102 purports to state a reason for its inclusion: "The term investment property includes a 'securities account' in order to facilitate transactions in which a debtor wishes to create a security interest in all of the investment positions held through a particular account rather than in particular positions carried in the account."[104] The Article 9 comments provide no other explanation of why a subtype of securities account is necessary. Comment 6 provides little justification for having a securities account be a subtype of collateral. A simple description of all security entitlements in all financial assets credited to a specific securities account would be sufficient to create a blanket security interest in all of the financial assets credited to a securities account.[105]

Worse, as discussed in Subparts C, D, and E below, although there is no need to have securities accounts as a subtype of collateral, some of the provisions of Article 9 governing the attachment, perfection, control, and priority of a security interest in a securities account contain several significant drafting errors. In these sections, Article 9 erroneously confuses the top or first-tier security entitlement in a financial asset with a second-tier security entitlement, which constitutes the financial asset underlying the

103. *Id.* § 9-607(a)(4), (5), *quoted in* text accompanying note 67 *supra*.

104. *Id.* § 9-102 cmt. 6, para. 1.

105. *See id.* § 9-108(d) (providing that that with the exception of consumer transactions "a description of a security entitlement, securities account, or commodity account is sufficient if it describes: (1) the collateral by those terms or as investment property; or (2) the underlying financial asset or commodity contract").

top or first-tier security entitlement. One significant example of this confusion creates a gap in the control provision for securities accounts that can produce a failure of control, which is discussed in Subpart C below. This error affects the legal opinions on perfection of security interests in securities accounts. The second significant instance of this confusion creates a gap in the priority rules for security entitlements, which is discussed in Subpart D below. This gap cannot be cured without revision of the statutory language. Finally, Subpart E below describes the errors in the sections providing that attachment and perfection of a security interests in a securities account automatically extend to some but not all of the financial assets credited to the securities account.

C. Drafting Error in Control of a Securities Account

As described above, a secured party can perfect a security interest in a security entitlement by control pursuant to Section 9-314,[106] Section 9-106,[107] and Section 8-106(d).[108] In addition, Section 9-106(c) states when a secured party has "control" of a securities account: "A secured party having control of *all security entitlements* or commodity contracts *carried in a securities account* or commodity account has control over the securities account or commodity account."[109]

Although not obvious to a casual observer, the terminology "control of all security entitlements *carried* in a securities account" is wrong. The correct phrase would state, "control of all security entitlements *in financial assets carried* in a securities account." The correct statement would refer to control of the top or first-tier (from the investor's perspective) security entitlement in financial assets credited to the securities account, like the security entitlement of Investor *A* in Example 1: Table 2. The actual language of the section, however, refers to control of all second-tier security entitlements that constitute financial assets that underlie the top or first-tier security entitlement, like the security entitlement of Regional Broker *A* that Regional Broker A has credited to Investor *A*'s securities account in Example 1: Table 2. The mistaken language refers to control of the wrong security entitlement.

A review of the operative defined terms for the legal regime for the indirect holding system reveals why the phrase "control of all security entitlements *carried* in the securities account" is a mistake and why the

106. *See id.* § 9-314(a), *quoted supra* note 41.
107. *See id.* § 9-106(a), *quoted supra* note 98.
108. *See id.* § 8-106(d), *quoted supra* note 99.
109. *Id.* § 9-106(c) (emphasis added).

phrase should have said "control of all security entitlements *in financial assets carried* in the securities account." Under the definitions of securities account, security entitlement, and entitlement holder, a security entitlement owned by a debtor gives the entitlement holder certain rights with respect to *financial assets* credited to or "carried in" the account.[110] Section 8-104(c) expressly references financial asserts that include security entitlements. This subsection states: "A person who acquires a *security entitlement to a security or other financial asset* has the rights specified in Part 5, but is a purchaser of *any security, security entitlement, or other financial asset* held by the securities intermediary only to the extent provided in Section 8-503."[111] The comments to various sections of Article 8 also state the point expressly.[112]

The security entitlement is distinct from the underlying financial asset, and the entitlement holder's interests in the underlying financial asset are limited. Although Section 9-503(a) provides that interests in a financial asset are held by the securities intermediary for the entitlement holders and are not property of the securities intermediary,[113] Section 9-503(c) provides that an entitlement holder may only enforce its property interest in a particular underlying financial asset by exercising the entitlement holder's

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110. *See id.* § 8-501(a), *quoted in* text accompanying note 81 *supra* (defining securities account); *id.* § 8-102(a)(17), *quoted in* text accompanying note 82 *supra* (defining security entitlement); *id.* § 8-102(a)(7), *quoted in* note 83 *supra* (defining entitlement holder).

111. *Id.* § 8-104, *quoted supra* note 101 (emphasis added).

112. *See id.* § 8-102 cmt. 17 ("'Security entitlement' means the rights and property interest of a person who holds securities or other financial assets through a securities intermediary. A security entitlement is both a package of personal rights against the securities intermediary and an interest in the property held by the securities intermediary."); *id.* § 8-501 cmt. 1 ("Part 5 rules apply to security entitlements, and Section 8-501(b) provides that a person has a security entitlement when a financial asset has been credited to a 'securities account.' Thus, the term 'securities account' specifies the type of arrangements between institutions and their customers that are covered by Part 5."); *id.* cmt. 4 ("Part 5 of Article 8 sets out a carefully designed system of rules for the indirect holding system. Persons who hold securities through brokers or custodians have security entitlements that are governed by Part 5, rather than being treated as the direct holders of securities.")

113. Section 8-503(a) states:

> To the extent necessary for a securities intermediary to satisfy all security entitlements with respect to a particular financial asset, all interests in that financial asset held by the securities intermediary are held by the securities intermediary for the entitlement holders, are not property of the securities intermediary, and are not subject to claims of creditors of the securities intermediary, except as otherwise provided in Section 8-511.

Id. § 8-503(a).

rights under Sections 8-505 through 8-508.[114] The entitlement holder's right to enforce its interest in the underlying financial asset against a purchaser of the underlying financial asset is further limited.[115]

The term "carried in" is comparable to the term "credited to," and it specifically modifies not the security entitlement in the underlying financial asset but the security entitlements that constitute the financial asset. For example, as stated in Section 9-106(c) and as discussed in Part IV below, the term "carried" correctly refers to commodity contracts carried in or credited to the commodity account.[116] Further, in Section 9-102, Comment 6 and in several comments in Article 8, with one exception, the term "carried" refers to the financial assets credited to the securities account.[117]

As noted above, a financial asset is either a security or any other property that a securities intermediary agrees to treat as a financial asset.[118] Accordingly, a financial asset credited to a securities account can include a security entitlement owned by the securities intermediary in financial assets held at a lower tier by another securities intermediary in another securities account. As illustrated in Example 1: Table 2, Investor *A* has a security entitlement in a financial asset credited by Regional Broker *A* to Investor *A*'s securities account that itself consists of a security entitlement, of which Regional Broker *A* is the entitlement holder, in financial assets credited by Participant to Regional Broker *A*'s securities account.

Because of the pervasiveness of the indirect holding system for securities, when an investor as entitlement holder has a security entitlement in financial assets credited to a securities account, in a large number of cases the underlying financial assets may be only security entitlements. In these cases, the debtor that is an entitlement holder has a first-tier security

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114. *See id.* § 8-503(c) ("An entitlement holder's property interest with respect to a particular financial asset under subsection (a) may be enforced against the securities intermediary only by exercise of the entitlement holder's rights under Sections 8-505 through 8-508.") In addition, if the securities intermediary fails to maintain sufficient financial assets to satisfy all of the claims of entitlement holders, each entitlement holders only has a pro-rata interest in the financials assets. *See id.* § 8-503(b), *quoted supra* note 89.

115. *See id.* § 8-503(d).

116. *See id.* § 9-106(c); *see also id.* § 9-102(a)(14)-(16) & cmt. 6., para. 3; *id.* §§ 9-106(b), 9-203(h), 9-308(g).

117. *See id.* § 9-102 cmt. 6, para. 1, *quoted in* text accompanying note 104 *supra*; *id.* § 8-106 cmt. 4, examples 7 & 8; *id.* § 8-115 cmt. 1, example 2; *id.* § 8-501 cmt. 5, paras. 1, 2. The exception appears in Section 8-510, which was added in 2001 and which reflects the confusion between security entitlements carried in a securities account and security entitlements in financial assets carried in a securities account. *See id.* § 8-510.

118. *See id.* § 8-102(a)(9), *quoted and discussed in supra* text accompanying note 85.

entitlement in financial assets that consist solely of underlying security entitlements credited to, or carried in, the securities account. The underlying security entitlements are second-tier security entitlements, and the securities intermediary is the entitlement holder in financial assets held at the third tier by another securities intermediary. As Example 1: Table 1 and Example 1: Table 2 above show, there are typically several tiers of security entitlements going back to the underlying security held by DTC or a federal reserve bank.

As discussed in greater detail below, in a large number of secured transactions an investor may own a security entitlement in financial assets credited to a securities account that include uncertificated securities as well as underlying security entitlements. The uncertificated securities are issued directly by the issuer. Instead of having the uncertificated securities registered in the name of the investor, however, the investor directs the issuer to register the uncertificated securities in the name of the securities intermediary, and the securities intermediary credits such uncertificated securities to the investor's securities account. As a result, the investor, as entitlement holder, has a security entitlement in financial assets consisting of both underlying security entitlements and underlying uncertificated securities.[119] In a smaller number of cases, the financial assets credited to a securities account also consist partly or wholly of certificated securities.

If a person owns both security entitlements and certificated or uncertificated securities and grants a security interest in them to a secured party, the secured party can obtain control in two different ways to perfect the security interest: (1) The secured party can obtain direct control over each type of security or security entitlement, or (2) the secured party can cause a debtor to credit the debtor's securities and security entitlements to a new securities account in exchange for a new security entitlement and then obtain control of the new security entitlement.

The following examples, Examples 2 and 3, illustrate these two methods. Assume that Investor *A* has the following investment property items:

> (i) a security entitlement in financial assets representing 10,000 shares of *XYZ* Company that Regional Broker *A* has credited to a securities account maintained by Regional Broker *A* as securities intermediary for Investor *A*, as described in Example 1: Table 2

119. This often will happen in large financing transactions in which a collection account or distribution account must hold short term securities that are invested until payment from the account. These securities may include rated uncertificated securities issued by money market funds.

> above. These financial assets consist of Regional Broker *A*'s security entitlement in 10,000 shares of the 50,000 shares of *XYZ* that Participant has credited to a securities account maintained by Participant as securities intermediary for Regional Broker *A*;[120]
>
> (ii) 5000 shares in Mutual Fund in the form of uncertificated securities registered in Investor *A*'s name; and
>
> (iii) Trust Certificates evidencing the ownership interest in a Delaware statutory trust that are evidenced by certificated securities registered in the name of Investor *A* and held by Investor *A*.

Investor *A* as debtor grants a security interest in all three of these investment property items to First Bank to secure a loan.

Example 2. First Bank could perfect its security interest in these three investment property items by using the three different methods of giving First Bank control under Sections 8-106(b), (c) and (d) for each investment property item. For the security entitlement in the 10,000 shares of *XYZ*, First Bank could have Investor *A* as debtor, Regional Broker *A* as securities intermediary, and First Bank as secured party enter into a control agreement by which Regional Broker *A* as securities intermediary would agree to follow entitlement orders from First Bank as secured party without the consent of the debtor Investor *A*. This control agreement gives First Bank control of Investor *A*'s security entitlement.[121] For the shares in Mutual Fund and the Trust Certificates, Investor *A* could have them reregistered in the name of First Bank and have the Trust Certificates delivered to First Bank.[122]

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120. The financial assets held by Participant consist of a portion of a security entitlement in 100,000 shares of *XYZ*. in financial assets consisting of securities credited by DTC to a securities account that DTC maintains for Participant.

121. *See* U.C.C. § 8-106(d)(2), *quoted supra* note 99. In addition, if First Bank has an account with Regional Broker *A*, Investor *A* could direct Regional Broker *A* to make First Bank the entitlement holder with a security entitlement in Regional Broker *A*'s underlying security entitlement for 10,000 shares of *XYZ* (out of 50,000 shares) in financial assets held by Participant in the form of a security entitlement for 100,000 shares issued to DTC). *See id.* § 8-106(d)(1), *quoted supra* note 99.

122. Subsections 8-106(b) and (c) state:

> (b) A purchaser has "control" of a certificated security in registered form if the certificated security is delivered to the purchaser, and:
>
> (1) the certificate is indorsed to the purchaser or in blank by an effective indorsement; or

The following figure illustrates this form of the transaction.

Example 2: Figure 2

XYZ/DTC/Participant - - - - >	Reg. Broker *A* - - - >	Inv. *A* - - - >	First Bank
Security/sec. ent.	sec. ent.	sec. ent.	security interest.
100,000/100,000 sh.	50,000 sh.	10,000 sh.	control agmt-debt.-sec. int.
Mutual Fund - - - - - - - - - - - - - - - - - - >		Inv. *A* - - - >	First Bank
		uncert. sec.	security interest.
		5000 sh.	registered to FB
Delaware statutory trust - - - - - - - - - - -- >		Inv. *A* - - - >	First Bank
		cert. sec.	security interest.
		5000 sh.	registered to/ poss by FB

Example 3. On the other hand, as a matter of convenience, First Bank could perfect its security interest by control by having Investor *A* transfer all three of these investment property items to First Bank's own securities custodian, Beta & Co. Beta & Co. would establish a new securities account for Investor *A*, agree to treat these three investment property items as financial assets, and credit these three investment property items to the new securities account held by Beta & Co. for Investor *A*.

In the case of Investor *A*'s security entitlement in *XYZ* shares, Investor *A* would direct Regional Broker *A* to establish a new securities account for Beta & Co. and credit Regional Broker *A*'s security entitlement in the *XYZ* shares that Regional Broker *A* had previously credited to Investor *A*'s securities account to the new securities account held by Regional Broker *A* for Beta & Co. Hence, Beta & Co. would become the new entitlement

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(2) the certificate is registered in the name of the purchaser, upon original issue or registration of transfer by the issuer.

(c) A purchaser has "control" of an uncertificated security if:

(1) the uncertificated security is delivered to the purchaser; or

(2) the issuer has agreed that it will comply with instructions originated by the purchaser without further consent by the registered owner.

Id. § 8-106(b), (c). Section 8-301 defines delivery:

(a) Delivery of a certificated security to a purchaser occurs when:

(1) the purchaser acquires possession of the security certificate;

. . . .

(b) Delivery of an uncertificated security to a purchaser occurs when:

(1) the issuer registers the purchaser as the registered owner, upon original issue or registration of transfer . . . .

Id. § 8-301.

holder for that underlying, second-tier security entitlement. In the case of the securities, Investor *A* would instruct the issuers of the Mutual Fund shares and the Trust Certificates to reregister them in the name of Beta & Co. and have the Trust Certificates delivered to Beta & Co. Beta & Co. would then credit the Mutual Fund shares and the Trust Certificates to a new securities account that it maintains for Investor *A* as entitlement holder as financial assets along with Beta & Co.'s new security entitlement in the 10,000 shares of *XYZ*.

This is a common arrangement for large financial transactions, such as securitizations.[123] Investor *A* as entitlement holder has a new first-tier security entitlement in the financial assets credited by Beta & Co. to a new securities account for Investor *A*. The financial assets consist of (1) a second-tier, underlying security entitlement in the 10,000 shares of *XYZ* of which Beta & Co. is the entitlement holder and (2) securities consisting of the Mutual Fund shares and the Trust Certificates, of which Beta & Co. is the registered owner.

First Bank as secured party, Investor *A* as debtor, and Beta & Co. as securities intermediary would enter into a control agreement by which Beta & Co. as securities intermediary agrees that it will comply with entitlement orders issued by First Bank as secured party without the consent of Investor *A*, the debtor and entitlement holder. At this point, First Bank as the secured party has control of Investor *A*'s security entitlements in all three underlying financial assets.[124] With control of the new security entitlement, First Bank has attachment[125] and perfection.[126] Because First Bank has control of this new security entitlement, it has all of the control that it needs.

As noted above, Section 9-106(c) redundantly provides that First Bank has control of the securities account to which the three underlying

123. *See* UNIF. COMMERCIAL CODE, art. 8, pref. note, pt. III.C.4 (1994), 2C U.L.A. 443 (2005) (noting that brokers will commonly hold mutual fund shares in a securities account for its customers to give the customers liquid cash assets and that this arrangement gives the customer a security entitlement in the mutual fund shares).

124. *See* U.C.C. § 8-106(d)(2), *quoted supra* note 99. In addition, First Bank could act as securities intermediary and credit the security entitlement, the Mutual Fund Shares and the Trust Certificates to a securities account that it maintains on behalf of itself as entitlement holder, *see id.* § 8-106(d)(1), *quoted supra* note 99, or on behalf of Investor *A* as entitlement holder, in which case it would enter into a control agreement as both securities intermediary and as secured party with Investor *A*.

125. *See id.* § 9-203(b)(3)(D), *quoted supra* note 9.

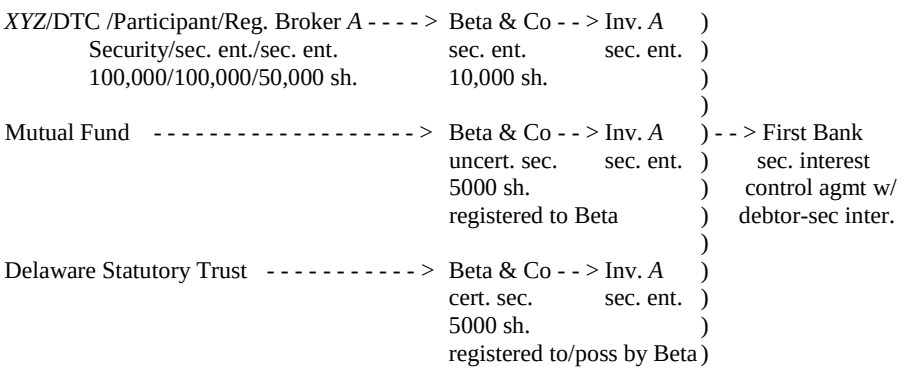
126. *See id.* § 9-314(a), *quoted supra* note 41; *id.* § 9-106(a), *quoted supra* note 98; *id.* § 8-106(d), *quoted supra* note 99.

investment property items are credited if it has "control of all security entitlements . . . carried in a securities account."[127] By this flawed definition of control, First Bank has control of the securities account if it has control of Beta & Co.'s underlying or second-tier security entitlement in the 10,000 shares of *XYZ* credited to the securities account.

First Bank, as the secured party, has direct control over Investor *A*'s security entitlement but First Bank does not have direct control of Beta & Co.'s second-tier security entitlement underlying Investor *A*'s security entitlement. Instead, Beta & Co.—not First Bank—has direct control of the financial asset consisting of this second-tier security entitlement. However, Section 8-104(b) arguably gives First Bank indirect control. This section states that a person acquires a financial asset other than a security if the person acquires a security entitlement in the financial asset.[128] Accordingly, by this provision, First Bank as secured party arguably has control of the second-tier security entitlement in the 10,000 shares of *XYZ* credited to the securities account maintained by Beta & Co. This definition of control for the securities account produces the anomaly that, by obtaining control of one of the three forms of financial assets, Beta & Co.'s underlying, second-tier security entitlement, the secured party has control of the entire securities account to which the Mutual Fund shares and the Trust Certificates are also credited.

The following figure illustrates this form of the transaction.

Example 3: Figure 3

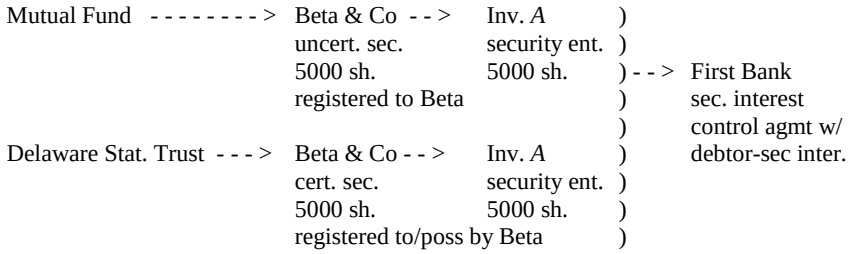


127. *Id.* § 9-106(c), *quoted in* text accompanying note 109 *supra*.
128. *Id.* § 8-104, *quoted supra* note 101.

A simple modification of the example exposes the drafting flaw in Section 9-106(c). Assume that First Bank no longer requires that Investor *A*'s security entitlement in the 10,000 shares of *XYZ* serve as collateral for the secured loan. Investor *A* with First Bank's consent would instruct Beta & Co. to transfer Beta & Co.'s underlying, second-tier security entitlement in the 10,000 shares of *XYZ* to another purchaser. As a result of such a transfer, Beta & Co.'s underlying, second-tier security entitlement in the 10,000 shares of *XYZ* would no longer be a financial asset underlying Investor *A*'s security entitlement subject to First Bank's control. The remaining financial assets credited by Beta & Co. to Investor *A*'s securities account would consist only of the Mutual Fund shares and the Trust Certificates, which are securities. Therefore, because there would no longer be any underlying security entitlements credited to or carried in the securities account maintained by Beta & Co., First Bank as secured party would not have control of the securities account.

The following figure illustrates this form of the transaction.

Example 4: Figure 4



As a practical matter this lack of control of the securities account does not harm First Bank as long as First Bank has control of Investor *A*'s security entitlement. If First Bank, as the secured party, has control of Investor *A*'s security entitlement, the removal does not affect control of Investor *A*'s security entitlement in the Mutual Fund shares and the Trust Certificates credited to the securities account maintained by Beta & Co. But it would be technically inaccurate to conclude that First Bank has control of the securities account even though providing such control was the intent of the flawed definition of control of the securities account.

The potential for loss of control, however, could have a significant effect on legal opinions delivered by law firms that a secured party has control of a securities account. Specifically, the Illustrative Security Interest Opinion attached as Appendix A to the *Special Report of the Tribar Opinion*

Committee: U.C.C. Security Interest Opinions—Revised Article 9,[129] provides an example of a legal opinion on perfection of a security interest in a securities account by control: "The Article 9 Security Interest in the Securities Account [is perfected by] [will be perfected upon] the execution and delivery of the Securities Account Control Agreement."[130] Although the Special Report discusses perfection of a security interest in security entitlements by control,[131] the Illustrative Security Interest Opinion makes no mention of perfection of a security interest in security entitlements and addresses only the securities account.

Often, the Illustrative Security Interest Opinion will be correct as a factual matter because frequently the financial assets credited to or carried in a securities account will include underlying security entitlements. Nevertheless, if the investment property credited to a securities account consists of money market funds, which are typically evidenced by uncertificated securities, there easily could be times when there are no security entitlements credited to the securities account. Legal opinions should not depend on the serendipitous existence of facts. In view of the potential loss of control under Section 9-106(c) and the overall uselessness of securities account as a subtype of collateral, a security interest opinion for investment property consisting of security entitlements must address control of the security entitlements, not control of the securities accounts.

This absence of control also arises in other transactions in which the financial assets credited to a securities account consist wholly of property items that are neither securities nor security entitlements. Two examples of other property items that are treated as financial assets are insurance policies, such as life insurance policies, and commercial loans.[132] In both cases, the owner of these assets transfers them to a person that agrees (1) to act as a securities intermediary as the nominal owner, (2) to establish a securities account for the owner, (3) to treat these assets as financial assets, and (4) to treat the owner as the entitlement holder.

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129. *Special Report of the Tribar Opinion Committee: U.C.C. Security Interest Opinions—Revised Article 9*, 58 BUS. LAW. 1449, 1504 (2003).

130. *Id.* at 1508 (alteration in original) (footnotes omitted).

131. *See id.* at 1449-94, 1499-1501.

132. Flener v. Alexander (*In re* Alexander), 429 B.R. 876 (Bankr. W.D. Ky. 2010), *aff'd sub nom.* Monticello Banking Corp. v. Flener (*In re* Alexander), No. 11-5054, 2011 WL 9961118 (6th Cir. Dec. 14, 2011), *discussed in* text accompanying notes 146-156 *infra*, also involves a security entitlement in a security entitlement in deposit accounts and illustrates the problems that can arise from a failure to distinguish a security entitlement from a financial asset that directly or indirectly underlies the security entitlement.

The owner may do this to facilitate multiple transfers of assets that otherwise have more onerous requirements for transfer, such as consent from the account debtor or obligor on the assets. As an entitlement holder of a security entitlement in these financial assets, the owner, as the debtor, and the secured party can create and perfect a security interest in these kinds of financial assets without having to transfer them. The debtor and the secured party need only enter into a control agreement with the securities intermediary giving the secured party control of the security entitlement in these financial assets. The control of the security entitlements is sufficient for the secured party. There is no need for control of the securities account itself. In any event, in this type of transaction, the secured party does not have control of the securities account because it does not have control of any "security entitlements carried in the securities account."

D. Drafting Error and the Gap in the Priority Rules for Security Entitlements

The drafting error in Section 9-106(c) that erroneously refers to securities entitlements "*carried in*" the security account instead of security entitlements "*in financial assets carried in*" the securities account also appears in the priority rules for conflicting security interests in security entitlements perfected by control. Section 9-328 provides the priority rules for security interests in investment property. The first rule is set forth in Section 9-328(1), which gives a secured party having control of investment property priority over a secured party perfected other than by control (generally, by filing).[133] This rule is fine.

The second rule, set forth in Section 9-328(2), attempts to provide a priority rule for conflicting security interests in investment property perfected by control on the basis of the time when the contending secured parties obtained control. Specifically, Section 9-328(2) states:

> Except as otherwise provided in paragraphs (3) and (4), conflicting security interests held by secured parties each of which has control under Section 9-106 rank according to priority in time of:
>
> (A) if the collateral is a security, obtaining control;

133. U.C.C. § 9-328(1) (providing that a "security interest held by a secured party having control of investment property under Section 9-106 has priority over a security interest held by a secured party that does not have control of the investment property"); *id.* § 9-312(a) (providing that a security interest in investment property may be perfected by filing), *quoted supra* note 96.

> (B) if the collateral is a security entitlement *carried in a securities account* and:
>
> (i) if the secured party obtained control under Section 8-106(d)(1), the secured party's becoming *the person for which the securities account is maintained*;
>
> (ii) if the secured party obtained control under Section 8-106(d)(2), the securities intermediary's agreement to comply with the secured party's entitlement orders with respect to *security entitlements carried or to be carried in the securities account*; or
>
> (iii) if the secured party obtained control through another person under Section 8-106(d)(3), the time on which priority would be based under this paragraph if the other person were the secured party.[134]

The priority rule in Section 9-328(2)(A), based on timing of control of securities, works. As written, however, the priority rule for security entitlements in Section 9-328(2)(B) makes no sense.

First, the introductory conditional clause—"if the collateral is a security entitlement *carried in a securities account*"—is expressly limited to the underlying, second-tier "security entitlement carried in the securities account" instead of "security entitlement *in [the underlying] financial assets* carried in the securities account." This wording excludes several categories of investment property.

Example 3 discussed above[135] illustrates the gaps. Investor *A* has a newly created security entitlement in financial assets held by Beta & Co. as securities intermediary and has granted a security interest in this security entitlement to First Bank perfected by a control agreement among Investor *A* as debtor and entitlement holder, Beta & Co. as securities intermediary, and First Bank as secured party. The financial assets underlying Investor *A*'s security entitlement consists of (1) Beta & Co.'s security entitlement in 10,000 shares of *XYZ* credited to Beta & Co.'s securities account maintained by Regional Broker *A* for Beta & Co., (2) Mutual Fund shares evidenced by uncertificated securities registered in Beta & Co.'s name, and (3) Trust Certificates evidenced by certificated securities registered in Beta & Co.'s name and possessed by Beta & Co.

134. *Id.* § 9-328(2) (emphasis added).
135. *See supra* text following note 122.

The introductory conditional clause of Section 9-328(2)(B), however, includes only First Bank's security interest in Beta & Co.'s underlying security entitlement. The language does not include First Bank's security interest in Investor *A*'s security entitlement in all three forms of financial assets credited to Investor *A*'s securities account, and it does not include First Bank's derivative security interest[136] in the underlying Mutual Fund shares or Trust Certificates. There is no express priority rule for these three different property items.

If, however, the introductory phrase had simply used only the words "security entitlement" without the "carried in the securities account" or had stated "security entitlement *in [the underlying] financial assets* carried in the securities account," then the priority rule would cover all potential property items: Investor *A*'s security entitlement, and the three different forms of financial assets credited to the underlying securities account. Section 9-328(2)(B) needs to be revised accordingly. This subsection could be interpreted in this way only on the grounds that the current wording is a scrivener's error.[137]

If the introductory clause of Section 9-328(2)(B) were revised, the three following clauses make sense. As written, however, they illustrate the error. The first two clauses refer to Investor *A*'s first-tier security entitlement, and not to Beta & Co.'s underlying or second-tier security entitlement in the 10,000 shares of *XYZ*. These clauses (i) and (ii) have no legal effect. The third clause, however, could refer to the underlying or second-tier security entitlement in the 10,000 shares of *XYZ*.

Clause (i) references the time when the secured party becomes the entitlement holder to achieve control. To acquire control in Example 3 above, First Bank, instead of Investor *A*, could become the entitlement holder only of the top- or first-tier security entitlement in the financial assets credited to the securities account maintained by Beta & Co. It would not be the entitlement holder for Beta & Co.'s underlying security entitlement in the financial assets credited by Regional Broker *A* to Beta & Co.'s securities account. Hence, clause (i) is inoperative.

Clause (ii) references the time when the securities intermediary enters into a control agreement with the secured party. Again, to provide First Bank control of Investor *A*'s security entitlement in financial assets credited

136. *See supra* note 128 and accompanying text.

137. *See* Reno v. American-Arab Anti-Discrimination Comm., 525 U.S. 471, 476-87 (1999) (describing a scrivener's error as a drafting error that results in a statute that cannot mean what it says and therefore empowers a court to substitute other words for the written word).

by Beta & Co. to a securities account for Investor *A*, Beta & Co. is the only securities intermediary that enters into a control agreement with First Bank as secured party. Regional Broker *A*, the securities intermediary for Beta & Co.'s second-tier, underlying security entitlement in the 10,000 shares of *XYZ*, has not entered into a control agreement with First Bank and normally would not do so. Hence, clause (ii) is also inoperative.

Clause (iii) references the time when another person has control of the security entitlement on behalf of the secured party.[138] In this instance, Beta & Co., as securities intermediary, has control of the underlying or second-tier security entitlement in the 10,000 shares of *XYZ* credited by Regional Broker *A* to Beta & Co.'s securities account. A typical control agreement by Beta & Co., as a securities intermediary, would not necessarily constitute an agreement to hold the underlying security entitlement on behalf of the secured party, First Bank. As securities intermediary, it is holding on behalf of the entitlement holder, Investor *A*. Nevertheless, depending on its wording, such an agreement could be construed to fit this clause (iii).

E. Other Errors in Attachment and Perfection for Securities Accounts

The failure to distinguish the security entitlement and the underlying financial assets appears elsewhere in Article 9 and in documents used in Article 9 transactions. As the discussion of one case at the end of this Subpart E shows, a failure to distinguish the security entitlement from the immediate or distant financial asset can have significant consequences.

As to Article 9, two other sections and one comment confuse a top- or first-tier security entitlement in financial assets credited to or carried in a securities account with the underlying or second-tier security entitlements credited to or carried in the securities account. First, Section 9-203(h) states: "The attachment of a security interest in a *securities account* is also attachment of a security interest in *the security entitlements carried* in the securities account."[139] Section 9-308(f) states: "Perfection of a security interest in a *securities account* also perfects a security interest in *the security entitlements carried* in the securities account."[140]

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138. *See* U.C.C. § 8-106(d)(3), *quoted supra* note 99. In addition, if First Bank has an account with Regional Broker *A*, Investor *A* could direct Regional Broker *A* to make First Bank the entitlement holder with a security entitlement in Regional Broker *A*'s underlying security entitlement for 10,000 shares of *XYZ* (which underlying security entitlement is an underlying security entitlement held by Participant, which maintains a security entitlement in the shares issued to DTC). *See id.* § 8-106(d)(1), *quoted supra* note 99.

139. *Id.* § 9-203(h) (emphasis added).

140. *Id.* § 9-308(f) (emphasis added).

These formulations contain two defects. First, the provisions refer to the creation of a security interest in the contractual relationship that constitutes the securities account. As a conceptual matter, and as discussed above, a securities account is not a property item in which persons can have property interests. The property item that can be the subject of a security interest is the security entitlement. Hence, where the word "securities account" appears, it should be revised and interpreted to read "security entitlement."

Second, to give full effect to automatic attachment and perfection, the operative language should state that attachment and perfection of a security interest in a security entitlement are also attachment and perfection of security interest in "the *financial assets credited to [or carried in]* the securities account." As written, the automatic attachment or perfection of a security interest in the security entitlements carried in a securities account does not expressly extend to the top- or first-tier security entitlement for which the securities account was created. Further, such automatic attachment and perfection does not extend to underlying financial assets that are not security entitlements.

These provisions serve no purpose. Article 9 permits the creation and perfection of a security interest in security entitlements. A secured party with such a security interest can enforce its security interest in the security entitlement or the underlying financial asset without purporting to have a security interest in the relationship that is the securities account and without having a direct security interest in the underlying financial assets.

Perfection of the security interest in the security entitlement protects that security interest from lien creditors and the bankruptcy trustee of the debtor, and perfection by control provides priority over any secured party perfected without control. Except for the lack of a priority rule, the drafting error has no substantive effect on secured parties so long as they obtain attachment and perfection of security interests in the first-tier security entitlements of their debtors. But these provisions should be deleted from Article 9. The existence of these erroneous provisions could produce unforeseen and unintended consequences.

Finally, as noted above, Section 9-108(d) provides a useful rule for identifying investment property as collateral.[141] Comment 4 to Section 9-108, however, reveals the same confusion about the distinction between a security entitlement in financial assets credited to a securities account and the securities account itself. This comment states:

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141. *See id.* § 9-108(d), *quoted supra* note 105.

> Investment Property. Under subsection (d), the use of the wrong Article 8 terminology does not render a description invalid (e.g., a security agreement intended to cover a debtor's "security entitlements" is sufficient if it refers to the debtor's "securities"). Note also that given the broad definition of "securities account" in Section 8-501, *a security interest in a securities account also includes all other rights of the debtor against the securities intermediary arising out of the securities account*. For example, a security interest in a securities account would include credit balances due to the debtor from the securities intermediary, whether or not they are proceeds of a security entitlement. Moreover, describing collateral as a securities account is a simple way of describing all of the *security entitlements carried in the account*.[142]

There are two problems with this comment. First, the second sentence of the comment is incorrect. No provision of either Articles 8 or 9 gives a secured party with a security interest in the securities account itself rights against the securities intermediary. On the other hand, the comment would be correct if it referred to a security interest in a security entitlement. Under Section 8-503(c), the only persons with rights against the securities intermediary are the entitlement holder and another person that has the power to give entitlement orders to the securities intermediary.[143] This third party would include a secured party with a security interest in the security entitlements in the financial assets credited to the securities account.

Similarly, the third sentence is incorrect. A security interest in a securities account *does not* include credit balances due to the debtor. The securities account includes the credit balances, and the entitlement holder has a security entitlement to the amount of such credit balances. This third sentence, however, ignores the important analytical step of identifying the property item in which the secured party has a security interest. As discussed above in Subpart B, the secured party can have a security interest in the debtor's security entitlement that enables the secured party, upon the debtor's default, to exercise the rights of the entitlement holder to the credit balances. The property item subject to the security interest is neither the securities account nor the credit balances in the securities account.

Second, the last sentence reveals the mixing confusion of tiers of security entitlements; it is simply wrong. "[D]escribing collateral as a securities

142. *Id.* § 9-108 cmt. 4 (emphasis added).
143. U.C.C. § 8-503(c), *quoted supra* note 114.

account" is *not* "a simple way of describing all of the *security entitlements carried in the account*." Instead, a correct statement could be, "[D]escribing collateral as a securities account is a simple way of describing all of the security entitlements *in the financial assets* carried in the account." Again, under the definitions of "securities account," security entitlement," and "entitlement holder," a security entitlement gives the entitlement holder certain rights with respect to *financial assets* credited to the account. As noted above, the comments to various sections of Article 8 state this point expressly.[144] Further, there is no reason for a securities account to be classified as a subtype of collateral to provide this descriptive benefit.[145]

Flener v. Alexander (*In re Alexander),*[146] which involved a security entitlement in a security entitlement in deposit accounts, illustrates the problems that can arise when parties to a secured transaction fail to distinguish a security entitlement from an underlying financial asset. In this case, Joe Alexander caused Monticello Bank to debit his savings account for approximately $201,000 in exchange for a security entitlement in a financial asset that the bank credited to a different account.[147] This account was referred to as "certificate of deposit #2581." [148] The underlying financial asset credited by Monticello Bank to this new account consisted of a security entitlement in financial assets held by the Bank of New York that the Bank of New York credited to the Monticello Bank's securities account at Bank of New York.[149] The underlying financial assets held by Bank of New York consisted of certificates of deposit (the "CDARS CD" for "Certificate of Deposit Account Registry Service certificates of deposit") that constituted "deposit accounts" and that were issued by three issuing banks in amounts to qualify for full deposit insurance by the Federal Deposit Insurance Corporation.[150]

Alexander then borrowed money from Monticello Bank and the bank took a security interest in Alexander's deposit accounts as security for the loan.[151] When the three underlying certificates of deposit matured, the funds were transferred from the issuing banks through Bank of New York to

144. *See supra* note 112.

145. *See supra* note 105 and accompanying text.

146. 429 B.R. 876 (Bankr. W.D. Ky. 2010), *aff'd sub nom.* Monticello Banking Co. v. Flener (*In re* Alexander), No. 11-5054, 2011 WL 9961118 (6th Cir. Dec. 14, 2011).

147. *Id.* at 878.

148. *Id.* at 879.

149. *Id.* at 878-79.

150. *Id.* at 878.

151. *Id.*

Monticello Bank and credited to Alexander's checking account.[152] The Bank then set off approximately $190,600 of this amount against the amount due the bank on Alexander's loan.[153] Alexander filed a chapter 7 bankruptcy petition shortly thereafter, and the bankruptcy trustee sought to avoid the set off on the grounds that the bank was not a secured creditor and therefore the payment was a preferential transfer to an unsecured creditor under Section 547 of the Bankruptcy Code.[154]

The written security agreement in favor of Monticello Bank described the collateral as all of Alexander's deposit accounts including certificate of deposit #2581 and not as a security entitlement, a securities account, or investment property. Alexander only had rights in a security entitlement.[155] For these reasons, the court held that the bank did not have a perfected security interest because the security agreement had not adequately described the collateral as required by Section 108 of the Kentucky UCC.[156]

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152. *Id.*

153. *Id.*

154. *Id.* at 878-90; *see also* 11 U.S.C. § 547 (2012).

155. *See Alexander*, 429 B.R. at 878.

156. *Id.* at 879. One issue not addressed in the case was whether the bank had a security interest because it had control. Under U.C.C. § 9-203(b)(3)(D) (AM. LAW INST. & UNIF. LAW COMM'N 2010), *quoted supra* note 9, no written security agreement is required for attachment of a security interest as long as the secured party has control of the security entitlement pursuant to a security agreement, which need not be an authenticated security agreement. Because the bank was both the securities intermediary and the secured party, it had control. *See id.* § 9-314(a), *quoted supra* note 41; *id.* § 9-106(a), *quoted supra* note 98; *id.* § 8-106(e) (providing that if "an interest in a security entitlement is granted by the entitlement holder to the entitlement holder's own securities intermediary, the securities intermediary has control"). The written security agreement creates a strong inference that the parties had an understanding—which is all that is necessary for a "security agreement," *see id.* § 1-201(b)(3) (defining an "agreement" as "the bargain of the parties in fact, as found in their language or inferred from other circumstances")—that the bank had a security interest in the securities account #2581. This identification would appear to be sufficient. The written agreement, however, expressly referred to this account #2581 and all other accounts exclusively as "deposit accounts." *See* Brief of Appellant at 12, Monticello Banking Corp. v. Flener (*In re* Alexander), No. 11-5054, 2011 WL 9961118 (6th Cir. Dec. 14, 2011), 2011 WL 2191643 at *7 (quoting the security agreement description of the collateral in full). Although the bank had control of the account, the bank's treatment of the account as a deposit account and not as a securities account was apparently, in the court's view, insufficient identification of the collateral.

IV. Commodity Account, Commodity Contract, and the Commodity Entitlement

A. The Commodity Entitlement as the Subtype of Collateral

The defined terms "commodity account" and "commodity contract" present the same need for revision and interpretation of these terms in the important sections of Article 9 to mean the debtor's rights arising out of the commodity account or commodity contract, which I call a "commodity entitlement." A commodity account is "an account maintained by a commodity intermediary in which a commodity contract is carried for a commodity customer."[157] A commodity account is a contractual relationship between the commodity customer and a commodity intermediary. A commodity customer is "a person for which a commodity intermediary carries a commodity contract on its books."[158] A commodity intermediary is a regulated futures commission merchant or a derivatives clearing organization.[159]

Similar to a deposit account and a securities account, a commodity account is a contractual relationship. The commodity account is not a thing or item in which one can have a property interest. The commodity customer only has a property interest in its rights under the agreement that creates the

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157. U.C.C. § 9-102(a)(14).

158. *Id.* § 9-102(a)(16). U.C.C. § 9-102(a)(17) defines "commodity intermediary" as "a person that: (A) is registered as a futures commission merchant under federal commodities law; or (B) in the ordinary course of its business provides clearance or settlement services for a board of trade that has been designated as a contract market pursuant to federal commodities law." The federal Commodity Exchange Act defines a "derivatives clearing organization":

> The term "derivatives clearing organization" means a clearinghouse, clearing association, clearing corporation, or similar entity, facility, system, or organization that, with respect to an agreement, contract, or transaction—
>
> (i) enables each party to the agreement, contract, or transaction to substitute, through novation or otherwise, the credit of the derivatives clearing organization for the credit of the parties;
>
> (ii) arranges or provides, on a multilateral basis, for the settlement or netting of obligations resulting from such agreements, contracts, or transactions executed by participants in the derivatives clearing organization; or
>
> (iii) otherwise provides clearing services or arrangements that mutualize or transfer among participants in the derivatives clearing organization the credit risk arising from such agreements, contracts, or transactions executed by the participants.

7 U.S.C. § 1a(15)(A) (2012).

159. *See id.* § 9-102(a)(17).

commodity account and applicable law—that is, the commodity entitlement. Although this relationship appears to resemble a securities account because of the reference to commodity contracts carried in the commodity account, it is operationally more similar to a deposit account because of the limited nature of a commodity contract.

Article 9 defines a commodities contract as a specialized contract or option regulated pursuant to United States or foreign commodities law.[160] In most cases, a commodity contract consists of a contract or option for a contract for the purchase or sale of a commodity for future delivery that the commodity customer enters into with a commodity intermediary to the extent permitted by the federal Commodity Exchange Act.[161] A commodity contract is a contract for the purchase and sale of goods for delivery. There are, however, important distinctions between a commodity contract and other contracts for the sale of goods.

For example, for any contract for the sale of goods for delivery on a future date for a fixed price, if the value of the goods changes between the

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160. *See id.* § 9-102(a)(15) (defining a "commodity contract" as "a commodity futures contract, an option on a commodity futures contract, a commodity option, or another contract if the contract or option is (A) traded on or subject to the rules of a board of trade that has been designated as a contract market for such a contract pursuant to federal commodities laws; or (B) traded on a foreign commodity board of trade, exchange, or market, and is carried on the books of a commodity intermediary for a commodity customer"); *see also id.* § 9-102 cmt. 6, para. 3 (stating that the category of commodity contracts "is essentially the same as the category of contracts that fall within the exclusive regulatory jurisdiction of the federal Commodity Futures Trading Commission").

161. *See* 7 U.S.C. § 6 (2012) (providing that unless exempted by the Commodities Futures Trading Commission "it shall be unlawful for any person to offer to enter into, to enter into, to execute, to confirm the execution of, or to conduct any office or business anywhere in the United States, its territories or possessions, for the purpose of soliciting or accepting any order for, or otherwise dealing in, any transaction in, or in connection with, a contract for the purchase or sale of a commodity for future delivery (other than a contract which is made on or subject to the rules of a board of trade, exchange, or market located outside the United States, its territories or possessions) unless—(1) such transaction is conducted on or subject to the rules of a board of trade which has been designated or registered by the Commission as a contract market or derivatives transaction execution facility for such commodity; (2) such contract is executed or consummated by or through a contract market; and (3) such contract is evidenced by a record in writing which shows the date, the parties to such contract and their addresses, the property covered and its price, and the terms of delivery . . ."); *see also* HÉLYETTE GEMAN, COMMODITIES AND COMMODITY DERIVATIVES: MODELING AND PRICING FOR AGRICULTURALS, METALS AND ENERGY 1-22 (2005); RONALD C. SPURGA, COMMODITY FUNDAMENTALS: HOW TO TRADE THE PRECIOUS METALS, ENERGY, GRAIN, AND TROPICAL COMMODITY MARKETS 5-13, 84-86, 95-96 (2006) (general description of futures contracts and specific examples of use of future contracts).

time of the contract and the time of delivery of the goods, the buyer or seller will each realize a gain or loss at the time of the delivery. For contacts that are not commodity contracts, however, the parties will not normally recognize any fluctuation in the value of the parties' respective rights and obligations under the contracts before the delivery date.

A commodity contract that specifies a fixed price to be paid on a future date for a particular commodity is different. The market value of the commodity will be calculated on each day until the delivery date. The net value of the right to payment and the right to delivery of the commodity under the commodity contract to the commodity customer and the commodity intermediary—the daily market value of the commodity less the contract price of the commodity—is "marked to market." This net value may fluctuate every day.

For example, a commodity customer may enter into a commodity contract to purchase crude oil for delivery several months later for a fixed price of $52 per barrel. If the daily market price of the crude oil is greater than $52 per barrel, say $54 per barrel, the commodity customer has a contractual right and obligation to purchase crude oil for the fixed price of $52 that is less than the $54 per barrel market value of the crude oil on that day. On that day, the commodity contract produces a net positive value of $2 in the commodity customer's favor which the commodity intermediary owes to the commodity customer. If, however, on any particular day the market price of the crude oil is less than $52 per barrel, say $50, the commodity customer has a contractual right and obligation to purchase crude oil for a fixed price of $52 that is higher than the $50 per barrel market value of the crude oil on that day. On this day, the commodity contract produces a net negative value for the commodity customer. The commodity customer owes this $2 of net negative value to the commodity intermediary, and the customer must pay to the commodity intermediary the $2 difference, the "margin," owed under the commodity contract.[162]

The commodity customer, the person that owns the commodity entitlement, does not have the same kinds of rights that an owner of rights under other contracts has. It cannot assign those rights in the same way that an owner of an account or payment intangible can assign those property items.[163] The commodity customer can only enter into and assign commodity contracts through the commodity intermediary. A commodity contract itself is not a property item that can be assigned. The essence of a

162. *See* U.C.C. § 9-102 cmt. 6, para. 6.

163. *See supra* notes 14-17 and accompanying text.

commodity customer's commodity entitlement, as both Comment 6 to Section 9-102 and the definition of "control" of a commodity contract in Section 9-106(b)(2) suggest,[164] is the right to direct disposition of the net positive value, if any, of the commodity contracts.[165] That value will equal, at any point in time, the amount by which the customer's right to payment under the commodity contract from the commodity intermediary exceeds the amount owed by the customer to the commodity intermediary. If the customer's right to payment is less than the amount that the customer owes, the commodity entitlement has no value.

Because neither the commodity account nor the commodity contract is a property item, those sections of Article 9 governing the creation, perfection, priority, or enforcement of a security interest in a commodity account or a commodity contract should be revised. Pending such revision, those sections should be interpreted to refer to the creation, perfection, priority, and enforcement of the security interest in the *commodity entitlement.* Attachment of a security interest to a commodity account or commodity contract under Sections 9-203(a) and (b) should be revised and interpreted as attachment of a security interest to the debtor's commodity entitlement with respect to the commodity account and commodity contracts.[166] The requirement of Section 9-203(b)(2) that the debtor have rights in the collateral is satisfied if the debtor has rights in the commodity entitlement. The debtor will have such rights if the debtor is the commodity customer with the commodity entitlement to the commodity contracts credited to the commodity account.

A lien creditor can obtain a lien only in the debtor's commodity entitlement and not in the commodity account or the commodity contract itself.[167] Perfection of a security interest in a commodity account or commodity contract as a subtype of investment property (by filing a financing statement pursuant to Section 9-312[168] or by control pursuant to the general rule of Section 9-314[169]) should be revised and interpreted as

164. *See* U.C.C. § 9-106(b)(2), *quoted infra* note 170; SPURGA, *supra* note 160, at 5-13, 84-86, 95-96.

165. *See* U.C.C. § 9-102 cmt. 6, para. 6, 8 (referring to the customer's "position" in the commodity account).

166. *Id.* § 9-203, *quoted supra* note 9.

167. *See* sources cited *supra* note 30.

168. U.C.C. § 9-312(a), *quoted supra* note 96.

169. *Id.* § 9-314(a) (stating that a "security interest in investment property, deposit accounts, letter-of-credit rights, or electronic chattel paper may be perfected by control of the collateral under Section 9-104, 9-105, 9-106, or 9-107").

the perfection of a security interest in the commodity entitlement as a subtype of investment property.

The general rule for perfection of a security interest in investment property by control in Section 9-314 refers to the specific rule in Section 9-106 for perfection of a security interest in investment property by control. Section 9-106(b) provides that specific rule for obtaining control of a commodities contract. Under Section 9-106(b), a person can obtain control of a commodity contract by becoming the commodity intermediary or by entering into a control agreement with the commodity customer and the commodity intermediary.[170] As mentioned above, the express provision reveals the limited nature of the commodity customer's commodity entitlement. A secured party has control if "the commodity customer, secured party, and commodity intermediary have agreed that the commodity intermediary will *apply any value distributed on account of the commodity contract* as directed by the secured party without further consent by the commodity customer."[171] Instead of referring to control of the commodity contract, however, the rule should state that a person obtains control of the commodity entitlement if the necessary steps are taken. This revision of the rule would mirror the rule for control of a security entitlement.[172]

Further, Section 9-106(c) provides that control of all "commodity contracts carried in a commodity account" is control of the account.[173] If Section 9-106(b) is revised to provide for control of the commodity entitlement, however, Subsection 9-106(c) becomes unnecessary. On the other hand, the rule for control of the commodity account in this subsection does not create the technical error that is present in the rule for control of a securities account, as discussed in Part III(C) above.

The same revision and interpretation that replaces "commodity entitlement" for commodity contract applies to the rules for the priority

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170. Section 9-106(b) states:

> (b) . . . A secured party has control of a *commodity contract* if:
>
> (1) the secured party is the commodity intermediary with which the commodity contract is carried; or
>
> (2) the commodity customer, secured party, and commodity intermediary have agreed that the commodity intermediary will apply any value distributed on account of the commodity contract as directed by the secured party without further consent by the commodity customer.

Id. § 9-106(b) (emphasis added).

171. *See id.* § 9-106(b)(2) (emphasis added).

172. *See id.* § 8-106(d), *quoted supra* note 99.

173. *Id.* § 9-106(c), *quoted in* text accompanying note 109 *supra*.

among conflicting interests in a commodity contract perfected by control[174] set forth in Section 9-328. Under Section 9-328(4), if the secured party is also the commodity intermediary, it is perfected pursuant to Section 9-106(b)(2), and it has priority over other secured parties perfected by control pursuant to a control agreement. As to secured parties perfected by control of a commodity account pursuant to a control agreement, under Section 9-328(4) the priority ranks according to time of obtaining control. In each of these cases, neither the debtor—the commodity customer—nor the secured party has any direct property interest in any commodity contract. Each merely has an ownership or security interest in the commodity entitlement. Hence, the reference to "commodity contract" in the first line of Section 9-328(2)(C) should be revised to refer to "commodity entitlement." The need for this revision and interpretation applies to a number of other sections in Article 9.[175]

In certain circumstances, however, as in the case of deposit accounts, reference to the commodity account will be sufficient for some purposes. For example, identification of the commodity account should be sufficient identification of a commodity entitlement under Section 9-108.[176]

B. A Specific Default Rule for the Commodity Entitlement

Unlike a deposit account and like a security entitlement, Article 9 does not contain any specific provision for enforcing a security interest in a commodity account or commodity contract. Nevertheless, under Section 9-607, if so agreed or after a default, a secured party "may enforce the obligations of [a] person obligated on collateral and exercise the rights of

174. *See id.* § 9-328(2)(C), (4).

175. *See id.* § 9-108(d), (e)(2) (setting forth permissible and impermissible ways to identify a commodity account); *id.* § 9-203(i) (providing that the "attachment of a security interest in a commodity account is also attachment of a security interest in the commodity contracts carried in the commodity account"); *id.* § 9-305(a)(4) (providing that the "local law of the commodity intermediary's jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a commodity contract or commodity account"); *id.* § 9-305(c)(3) (providing that the "local law of the jurisdiction in which the debtor is located governs . . . automatic perfection of a security interest in a commodity contract or commodity account created by a commodity intermediary"); *id.* § 9-308(g) (providing that "[p]erfection of a security interest in a commodity account also perfects a security interest in the commodity contracts carried in the commodity account"); *id.* § 9-309(11) (providing for automatic perfection upon attachment for "a security interest in a commodity contract or a commodity account created by a commodity intermediary"); *id.* § 9-328(2)(C), (4) (priority among secured parties with control of a commodity contract or commodity account).

176. *See id.* § 9-108(d), *quoted supra* note 105.

the debtor with respect to the obligation of the . . . person obligated on collateral to make payment or otherwise render performance to the debtor."[177] For collateral consisting nominally of a commodity account or commodity contract, the secured party can exercise the debtor's rights against the commodity intermediary as a person obligated on the collateral.

The vagueness of this language could thwart the efficient enforcement of a security interest in a commodity account. On the other hand, the specific definition of control of a commodity contract permitting the commodity intermediary to "apply any value distributed on account of the commodity contract" states the nature of the secured party's rights.[178] As a substantive matter, the secured party would be exercising the debtor's commodity entitlement arising out of the commodity contract and the commodity account. Nevertheless, to avoid uncertainty, a future revision of Article 9 should include a specific provision for the remedies of the secured party against a commodity contract comparable to that for deposit accounts.[179]

V. Conclusion: Interpretation and Revision

In the case of deposit accounts, the term "deposit entitlement" should become a type of collateral in lieu of the deposit account, and by revision of Article 9 the term "deposit account" should be replaced with, and pending such revision should be interpreted as, "deposit entitlement" in the provisions of Article 9 that govern creation, perfection, and priority of security interest in deposit accounts. These revisions and interpretations may help prevent courts from misunderstanding and misapplying these Article 9 provisions. Other references to the term deposit account, however, are appropriate.

In the case of securities accounts, Article 9 should be revised to remove both the term "securities account" as a subtype of collateral and the provisions for the creation, perfection, and control of security interests in securities accounts. Until such revision, with one exception, the provisions of Article 9 that govern security interests in securities accounts should be eschewed in favor of those provisions providing for creation, perfection, and priority of security interests in security entitlements and should not be relied upon. Law firms issuing security interest opinions should address control of security entitlements instead of control of securities accounts.

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177. *Id.* § 9-607(a)(3), *quoted supra* note 100.
178. *Id.* § 9-106(b)(2), *quoted supra* note 170.
179. *See id.* § 9-607(a)(4), (5), *quoted in supra* text accompanying note 67.

Further, the priority rules of Section 9-328(2)(B) must also be revised to refer not to "security entitlements *carried in* a securities account" but to "security entitlements *in financial assets carried in* a securities account." Such a revision would complete the priority rules for investment property. Pending such a revision, a court could reach the same result on the grounds that the current provisions constitute a scrivener's error. In addition, the default rules in Sections 9-607 and 9-610 should be revised to include specific provisions for liquidating a security entitlement and the financial assets underlying the security entitlement.

Finally, in the case of commodity accounts and commodity contracts, the term "commodity entitlement" should become a type of collateral in lieu of the terms "commodity account" and "commodity contract." The provisions of Article 9 that govern creation, perfection, and priority of security interests in commodity accounts and commodity contracts should be revised and, pending such revision, should be interpreted as referring to the commodity entitlement arising out of the commodity account and the commodity contracts credited to the commodity account. In addition, the default rules in Section 9-607 should be revised to include specific provisions for liquidating a commodity account comparable to the rules for deposit accounts.

These revisions and interpretations will align the language of Article 9 with the essential nature of these complicated property items and therefore will enhance the utility of Article 9's rules for the creation, perfection, priority, and enforcement of security interest in these property items. In the context of drafting and revising comprehensive statutory schemes, the necessity for these revisions and interpretations is not unusual. The drafting of Article 9—from its earliest beginnings in 1948 through its original enactment and subsequent revisions until its complete revision in 2001—benefited from substantial experience of the secured finance industry with the operation of the statute and trial and error in the drafting. The concepts of deposit accounts, securities accounts, and commodity accounts, which are conceptually more complex that many of the other types of Article 9 collateral, were included in Article 9 relatively recently in its evolution. Experience with these newer concepts reveals the necessity for these revisions and interpretations.