

Secured Transactions and Article 9 of the UCC: The role of banks as secured creditors in lending money for real estate purchase in the US.

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Abstract

The Uniform Commercial Code (“UCC”) in the United States (US) 1954 has been adopted by all the fifty states to create a uniform system of laws for commercial transactions. This includes personal loans from banks and credit institutions and secured transactions which are defined as any arrangement in which a creditor receives a security interest in the debtor's property. The creditor is known as the secured party who may hold a security interest in the debtor's property in order to ensure the debtor's payment. Article 9 is designed to clarify and create more flexible methods of perfecting security transactions on loans by the commercial sector including banks. This provision can successfully protect the interest of the banks in exercising their rights as the priority creditors in sales of possessory interest in land such as mortgages and in securing them against other lenders. The lender or a creditor will take a mortgage or a pledge in order to reduce the risk of losing the money they are owed. If the law or the way in which it is applied does not give creditors' confidence that they can recover real value from mortgaged or pledged assets, such a law will have little economic effect. The question is the scope of Article 9 and the role of the bank as the lender when there is an agreement to provide a loan for collateral such as a mortgage agreement and the control regime of the bank in securing deposit accounts as a secured creditor.

Key words:

UCC Article 9, secured transactions, mortgages, collateral, foreclosure, control regime.

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Introduction

In the US, secured transactions in the financial sector are integral to the banking law of the country. They allow the lenders to take a security interest in the collateral which are assets of the debtors and they provide lending institutions with legal redress in case of default by the borrower. The availability of such remedies encourages banks to extend capital at lower interest rates which allows the circulation of capital and facilitates economic growth. Article 9 of UCC is the instrument that governs transactions where security interests are taken in personal property, and it regulates creation and enforcement of security interests in movable property, intangible property, and fixtures. Article 9 abolishes the preponderance of case law, equitable and statutory rules, and replaces them with the functional concept of a "security agreement" creating an interest for the creditor. The process that requires analysis is the role of the bank as a secured creditor and the priority that it will have at the time of enforcement.²

The secured creditor is any creditor to whom the business has pledged collateral in exchange for a loan, line of credit, or purchase. The collateral might be business property, such as inventory and equipment, or personal property, such as the house, car, or boat. There are also "involuntary secured creditors" who are those who have filed a lien (legal claim) against the property because they have a judgment against the debtor or there is a tax debt owed. If the business cannot pay back the debt, a secured creditor can repossess or foreclose on the secured property, or order it to be sold, to satisfy the debt.³ The unsecured creditor is one to whom no collateral has been pledged and who has not filed a lien. The unsecured debts include credit card charges and amounts the business owes for inventory, office supplies, furnishings, rent, and advertising, as well as what is owed for services such as maintenance, equipment repair, or professional advice.

There are four kinds of assets that are purchased from a financial institution that are secured. The secured creditor is generally a bank or other asset-based lender that holds a fixed or floating charge over a business asset or assets. When a business becomes insolvent, sale of the specific asset over which security is held provides repayment for this category of creditor.

² Grant Gilmore, *Security Interests in Personal Property*, vol. 1 (Boston: Little, Brown & Co., 1965), Preface

³ Scott argues that a regime that privileges secured creditors over unsecured ones (or in other words, a system in which secured financing is more preferred than unsecured financing), may enhance social welfare and thus, Article 9 is an important promoter of social welfare. Robert Scott, *The Truth About Secured Financing*, 82 *Cornell Law Review*, 1456

These are classified into consumer goods (bought primarily for personal, family, or household purposes)⁴; inventory (e.g., anything being held for sale or lease, raw materials for that list),⁵ and the goods which are pledged as collateral are deemed to be covered under the secured interests. Similarly, if goods are rented to third parties by a borrower, those goods constitute "Inventory" under Article 9. The work in progress, or materials used or consumed in a business; agricultural products and equipment (anything that is not consumer goods, inventory, or farm products).⁶ There are several other defined terms in Article 9 which describe goods but which do not constitute a distinct category of collateral, such as Fixtures and Accessions. These categories of collateral could be consumer goods, equipment or inventory.

The Account created by the bank, which is the lender, establishes the category of accounts under the Right to Payment, which is the entitlement of the bank, and defines them as Accounts, Chattel Paper, Instruments, Investment Property, Deposit Accounts and it issues a "Letter of Credit Rights". The "Account" consists of a right to payment of a monetary obligation whether or not earned by performance for (1) property that has been sold, leased, licensed, assigned or otherwise disposed of; (2) services rendered or to be rendered; (3) energy provided or to be provided and (4) several other items.⁷ The "Instruments" that Article 9 provides in terms of lending include any negotiable deeds or other writing evidencing a right to the payment of money that (1) is not a security agreement or a lease; and (2) is of a type that in ordinary course of business is transferred by delivery with any necessary endorsement or assignment. These include promissory notes, checks and drafts but investment property and letters of credit are expressly excluded from the definition of an Instrument.⁸

The bank provides the "Investment Property" which means a security, whether certificated or uncertificated; securities account; securities entitlement; commodity account; or commodity contract.⁹ The examples of securities include stocks, bonds and similar assets that qualify as securities under Article 8 of the UCC. If it is certificated, there is a physical certificate evidencing that interest. If it is uncertificated, this means the rights are evidenced by a notation on the books of the issuer. The "Securities account" is the account in which a financial asset, ie a security is maintained by a bank or securities intermediary (like a broker). The "Securities entitlement" is the right of the

⁴⁴ See U.C.C. §9-102(a)(44). Consumer Goods are Goods that are used or bought for use primarily for personal, family, or household purposes. U.C.C. §9-102(a)(23)

⁵ See U.C.C. §9-102(a)(48)

⁶ U.C.C. §9-102(a)(33).

⁷ U.C.C. §9-102(a)(2).

⁸ U.C.C. §9-102(a)(47).

⁹ U.C.C. §9-102(a)(49).

investor with respect to such financial assets in a securities account. There is also the commodities future contract or option that is a securities account but has been signed between the bank and the account holder for commodities contracts. The "Deposit account" includes a demand, time, savings, passbook or similar account maintained with the bank and excludes investment property and accounts that are evidenced by an instrument.¹⁰

This paper enquires into the extent to which Secured Transactions under Article 9 of the UCC cover real property that has a mortgage outstanding when banks offer credit to their clients in the process of acquiring new property. The secured transactions are voluntary and both the creditor and the debtor agree to it ahead of time and the process cannot be compared with an involuntary process such as a judicial lien in insolvency. There is also discussion about the control mechanism in place in deposit accounts that enables a bank to enforce the debt and how Article 9 provides a flexible regime for secured creditors that provide the lien for the collaterals.

Bank as priority creditor

Article 9 applies to interests in both negotiable and non-negotiable instruments¹¹ and it applies to both a security interest in a mortgage note to secure an obligation and to the rights of a buyer of a mortgage note.¹² This provision determines the requirements for an "effective" transfer of rights in those two situations.¹³ The requirements for an effective transfer of ownership (in the case of a sale) or a security interest to secure an obligation (in the case of a loan secured by the mortgage note) are straightforward:

1. Value must be given--this is typically satisfied by the payment of the purchase price in the case of a sale of a mortgage note and the promise to make a loan or the advance of the loan amount in the case of a security interest to secure an obligation.¹⁴
2. The seller or person creating the security interest to secure an obligation must have "rights" in the mortgage note--this too is usually easy to satisfy.
3. Generally, the seller or person creating a security interest to secure an obligation must "authenticate" a security agreement describing the mortgage note.¹⁵ Whether the agreement covers the sale of the mortgage note or a security interest to secure an obligation, the agreement sufficiently describes the mortgage note if the agreement "reasonably identifies" the mortgage note.¹⁶ For example, a description of mortgage notes by "category" or "type" is sufficient.¹⁷

¹⁰ U.C.C. §9-102(a)(29).

¹¹ UCC § 9-102(a)(47)

¹² UCC § 9-109(a)(1) and (3).

¹³ UCC § 9-203

¹⁴ UCC § 1-204

¹⁵ UCC § 9-203(b)(3)(A).

¹⁶ UCC § 9-108(a).

¹⁷ UCC § 9-108(b)(2) and (3).

4. (An oral (or other unauthenticated) security agreement is also possible in some circumstances.¹⁸

If these requirements are satisfied, the buyer or lender with a security interest in a mortgage note to secure an obligation obtains a property interest in the note as owner or holder of the security interest to secure an obligation. The bank in a secured property transaction has to perfect its title by securing its interest in collateral and then it becomes the secured party when the interest attaches of the accountholder. Under the UCC Article 9, a security interest generally does not attach unless three basic requirements are met. These are based on the requirements that value be given for the security interest; the debtor has rights in the collateral (or power to transfer the collateral to a secured party); and the debtor “authenticates” a security agreement.¹⁹

The residential real estate foreclosures can lead to both the banks and unsecured creditors both applying for judicial and out of court settlements prior to any bankruptcy proceedings that become necessary.

The perfection of a security agreement allows a secured party to gain priority to the collateral over any third party, should the borrower default on the loan. This is known as priority. The creditor with the highest priority will be repaid before others if the borrower defaults and foreclosure occurs. Three exceptions exist for filing for perfection: automatic redemption, possession, and taking control of a deposit account. The most typical way to perfect a security interest is by filing notice in a public office.²⁰ The filing of a public notice puts other creditors on notice of the attached security interest in property of the creditor and protects against a secret lien.²¹ The required filing most frequently is a financing statement. However, for a financing statement to be valid, it must include the debtor's name, the secured party's name or the name of the secured party's representative, a description of the property covered by the statement. If any of those three elements are missing from a financing statement, the security interest will not be perfected. A financing statement is valid for five years from the date it was filed and can be extended.²²

¹⁸ UCC § 9-203(b)(3)(B)).

¹⁹ U.C.C. § 9-102.

²⁰ U.C.C. § 9-310.

²¹ D. Fenton Adams, “Sales of Personal Property as Secured Transactions Under Article 9 of the Uniform Commercial Code,” 31 U. Ark. Little Rock L. Rev. 1, 16 (2008).

²² UCC Financing Statements: Continuation and Lapse.<http://www.mcdr-law.com/Articles/UCC-Financing-Statements-Continuation-and-Lapse.pdf>

The law in the US has long followed the rule that wherever the mortgage note goes the related mortgage covered by the Article 9 process is set to follow.²³ UCC § 9-203(g) codifies this rule for both sales of a mortgage note and a security interest in a mortgage note to secure an obligation. Further, perfection of a security interest in the mortgage note (whether in favour of a buyer or a lender with a security interest to secure an obligation) also perfects the buyer's or lender's security interest in the seller's or borrower's rights in the mortgage. The references to a "mortgage" in UCC § 9-203(g) include other types of consensual rights in real property to secure an obligation, such as a deed of trust.²⁴

The issue is about getting the mortgage in the secured party's name which is to save effort and money for all concerned. Often a buyer of a mortgage note or a lender with a security interest in the mortgage note to secure an obligation will not record an assignment of the mortgage in the real estate records. Article 9 makes obvious that recording an assignment is not necessary for the buyer or lender to perfect its rights in the seller's or borrower's rights in the mortgage. Under UCC 9, a secured party may take a security interest, which "floats" over all of the debtor's assets present and future.²⁵ A floating charge is an important device because it is used for securing the obligation of bonds, and the mechanism significantly reduces the costs of issuing bonds. Moreover, the floating charge provided for bondholders invites this group of creditors to be more involved in the company's affairs, and in fact, to become joint-venturers.²⁶

However, if the buyer or lender wants to foreclose, it may not have and may not be able to obtain the documents necessary to record the assignment in the real estate records, which may be necessary under local real estate law. Article 9 provides a procedure for the buyer or lender to record a document in the real estate records to reflect that assignment.²⁷ Article 9 addresses some of the issues that have come up in enforcement of collaterals and the litigants and the courts considering these matters sometimes do not recognize the applicability of Article 9 in the rules of the UCC.

In *U.S. Bank v. Ibanez*,²⁸ there were two separate actions brought in the Land Court pursuant to G. L. c. 240, § 6, by the plaintiff banks, as trustees, seeking judgments declaring that they held clear title in fee simple to properties that they had foreclosed (having claimed the authority to foreclose as the eventual assignees of the mortgages)

²³ *Restatement (Third) of Property (Mortgages)* § 5.4 American Law Institute 2019
<https://www.ali.org/publications/show/property-mortgages/>

²⁴ UCC § 9-102(a)(55).

²⁵ Grant Gilmore, *supra* 2, p. 354-366

²⁶ Robert Scott, *The Truth about Secured Financing*, 82 *Cornell Review*, p 1456

²⁷ UCC § 9-607(b)

²⁸ 458 Mass. 637, 941 N.E.2d 40 (2011).

and purchased back at foreclosure sales. There was an application for foreclosure on July 5, 2007, by the U.S. Bank, as trustee, on the mortgage of Antonio Ibanez, who purchased the Ibanez property at the foreclosure sale. On the same day, Wells Fargo, as trustee, foreclosed on the mortgage of Mark and Tammy LaRace, and purchased the LaRace property at that foreclosure sale. In September and October of 2008, U.S. Bank and Wells Fargo brought separate actions in the Land Court under G. L. c. 240, § 6, which authorizes actions "to quiet or establish the title to land situated in the commonwealth or to remove a cloud from the title thereto." ²⁹

The two complaints sought identical relief: (1) a judgment that the right, title, and interest of the mortgagor (Ibanez or the LaRaces) in the property was extinguished by the foreclosure; (2) a declaration that there was no cloud on title arising from publication of the notice of sale in the Boston Globe; and (3) a declaration that title was vested in the plaintiff trustee in fee simple. U.S. Bank and Wells Fargo each asserted in its complaint that it had become the holder of the respective mortgage through an assignment made after the foreclosure sale.

The ruling affirmed the previous judgment that the securitization documents submitted by the plaintiffs failed to demonstrate that they were holders of the mortgages at the times of the publication of the notices of the foreclosure sales and of the sales themselves, and the judge therefore did not err in rendering judgments against the plaintiffs and in denying the plaintiffs' motions to vacate the judgments. ³⁰ It stated that Article 9 provides an overriding power. "Recognizing the substantial power that the statutory scheme affords to a mortgage holder to foreclose without immediate judicial oversight, we adhere to the familiar rule that "one who sells under a power [of sale] must follow strictly its terms. If he fails to do so there is no valid execution of the power, and the sale is wholly void." (Moore v. Dick, 187 Mass. 207, 211 (1905). See Roche v. Farnsworth, 106 Mass. 509, 513 (1871)) ((power of sale contained in mortgage "must be executed in strict compliance with its terms")). (See also McGreevey v. Charlestown Five Cents Sav. Bank, 294 Mass. 480, 484 (1936)). ³¹ The Court emphasised the procedural "related statutory requirement that must be strictly adhered to in a foreclosure by power of sale is the notice requirement articulated in G. L. c. 244, § 14. That statute provides that "no sale under such power shall be effectual to foreclose a mortgage, unless, previous to such sale," advance notice of the foreclosure sale has been provided to the mortgagor, to other interested parties, and by publication in a newspaper published in the town where the mortgaged land lies or of general circulation in that town. ³² "The manner in which the notice of

²⁹ Page 639

³⁰ At 645-655

³¹ At 647

³² Ibid

the proposed sale shall be given is one of the important terms of the power, and a strict compliance with it is essential to the valid exercise of the power."³³ The mortgage foreclosure "was not rendered invalid by its failure to record the assignment reflecting its status as holder of the mortgage prior to the foreclosure since it was, in fact, the holder by assignment at the time of the foreclosure, it truthfully claimed that status in the notice, and it could have produced proof of that status (the unrecorded assignment) if asked."³⁴ There was also reference to the alternative to foreclosure through the right of statutory sale which is foreclosure by entry, by which a mortgage holder who peaceably enters a property and remains for three years after recording a certificate or memorandum of entry forecloses the mortgagor's right of redemption. (See G. L. c. 244, §§ 1, 2; *Joyner v. Lenox Sav. Bank*, 322 Mass. 46, 52-53 (1947)). A foreclosure by entry may provide a separate ground for a claim of clear title apart from the foreclosure by execution of the power of sale. (See, e.g., *Grabiel v. Michelson*, 297 Mass. 227, 228-229 (1937)). Because the plaintiffs do not claim clear title based on foreclosure by entry, we do not discuss it further.³⁵

Article 9 of the UCC applies to all transactions that create security interests in personal property, regardless of the form of the transaction or the name that the parties give to it. The formulation of security agreements in connection with real estate must take special care to ensure that room revenues are brought into the purview of the applicable security agreements. The specific language must be in the security agreement itself, and *not* just in ancillary documents. The real property rights that the Article covers have to be in the form of security and it has to bind the collateral in the agreement in order for the bank to be a secured creditor in the transaction.

Article 9 and mortgage foreclosures

The mortgage loan generally consists of two documents, a promissory note and a security instrument (mortgage or deed of trust), and that the security instrument is a mere incident of the note. The role of UCC Article 3 and Article 9 need to be distinguished in foreclosing a mortgage by the bank. Article 3 of the UCC applies to most issues related to enforcement and collection of the debt evidenced by the promissory notes, including those issued in connection with mortgage loans. Under Article 3, promissory notes (while certainly having many elements of regular contracts) are a special category of an "instrument" which is similar to a bank cheque payable to an identified payee and may be transferred by physical possession. Article 9 of the UCC covers "Secured Transactions" which may at times apply to promissory notes secured by a mortgage or deed of trust ("DOT"). When a note is

³³ At 648

³⁴ Note 8

³⁵ Note 15

created and is secured by a mortgage or DOT, it may be transferred without a formal assignment contract, but by mere endorsement and transfer of possession. In allowing such transfers, the law makes the note a more easily transferable type of instrument. Generally, such transfers of the note will be governed by Article 3 and the security instrument (mortgage or DOT) incident to the note will follow the transfers automatically. However, what happens if the payee of the note (or the current party to whom the note has been transferred – "holder") will pledge the note as security for yet another loan. When transferring the note outright to another party, the holder of the note will borrow against it and will pledge it as a collateral. In this situation, the note (with its incidental security) is treated as "personal property," and Article 9 applies. The party advancing the loan funds against the note ("new lender") would obtain a security interest in the note and would also have a second-tier security interest in the collateral originally securing the note (i.e., the house).

Where the note itself is pledged as security for a new loan (rather than transferred/sold outright), the note's accompanying mortgage/DOT remains incident to the note and follows the note. That mortgage/DOT, in turn, represents an interest in (an encumbrance on) the house that served as collateral at the time the note was issued. Thus, this situation of a pledged note creates security within security: the house as collateral within the note, with the note itself given as collateral when pledged for a new loan. The new lender's security interest in the note would be perfected under Article 9 (provided the applicable requirements for perfection are met), but such lender's second tier security interest in the note's collateral (the house) would be unperfected unless recorded specifically against the property.³⁶

There is an important distinction between creating a security interest in real estate (such as when you issue a note payable to your lender and give the lender security in the house) and creating a security interest in personal property (such as giving a lender security in the note itself, which note may or may not itself be secured with real property). The transaction between mortgagee and the bank does not involve an outright transfer of the note to the bank and is notice to the bank "as security for a loan." There is a difference between selling real estate outright (without retaining any interest in it) and pledging something as security. The sale of the house to the bank is not the same as pledging your house to the bank as security for a loan and the same applies to a note instead of a house. The general rule of priority as creditor is the same for real property security as for personal property security: the first in time to give notice of the secured interest is first in right. The mortgagor's liability can terminate in three ways: payment, assumption (with a novation), or foreclosure. A bank might

³⁶ Rodney v. Arizona Bank, 836 P.2d 434, 172 Ariz. 221 (Ariz. App. Div. 2 1992).

make advances to the debtor after accepting the mortgage. If the future advances are obligatory, then the first-in-time rule applies.³⁷

Article 9 has created the framework for a control regime for a secured creditor by confirming their priority status. This is by perfection of a security right in a deposit account and control is a concept whose meaning varies according to whether the secured creditor is the bank with whom the grantor maintains the deposit account or a different creditor.³⁸ Article 9 has a framework for control by a secured creditor in the perfection and priority of a security right in a deposit account. Control is not a unitary concept. Its meaning varies according to whether the secured creditor is the bank with whom the grantor maintains the deposit account or an outside creditor.³⁹ If the bank is the secured creditor, it automatically has control upon its customer's grant of security to it.⁴⁰

If the secured creditor is an outside creditor, it can obtain control either by becoming the bank's customer with respect to its debtor's deposit account or by entering into a control agreement with the bank and the debtor under which the bank agrees that it will comply with instructions originated by the secured creditor directing disposition of the funds in the deposit account without further consent by the debtor.⁴¹ Walsh argues that the assumption of "control is an alternative to registration as a mode of perfecting a security interest in deposit accounts. This is so even though control does not give public notice of the potential existence of the security right to creditors and other potential competing claimants".⁴² The secured creditor's control needs not be exclusive: a secured creditor has control even if the debtor retains the right to direct the disposition of funds from the deposit account as if it were unencumbered.⁴³ Outside parties cannot require the bank to disclose whether a security right exists in the deposit account: a bank that has entered into a control agreement is not required to confirm the existence of the agreement to another person unless requested to do so by its customer.⁴⁴ The result is a "secret lien," the very mischief that the general requirement for perfection was intended to alleviate.⁴⁵

³⁷ Paul H. Cherry v. Chase Manhattan Mortgage Group 190 F.Supp.2d 1330 (Fed. Dist. Ct. FL 2002).

³⁸ R.C.C. CUMING, CATHERINE WALSH & RODERICK WOOD, *PERSONAL PROPERTY SECURITY LAW* (2d ed. 2012). at 664.

³⁹ U.C.C. § 9-104(a) (2014).

⁴⁰ *Id.* at § 9-104(a)(1).

⁴¹ *Id.* at § 9-104(a)(2)-(3).

⁴² Catherine Walsh, Justifications for UCC Article 9's Treatment of Deposit Accounts: A Comparative Note, 4 Penn. St. J.L. & Int'l Aff. 350 (2015). Available at: <http://elibrary.law.psu.edu/jlia/vol4/iss1/16>

⁴³ *Id.* at § 9-104(b).

⁴⁴ *Id.* at § 9-342.

⁴⁵ Lynn M. LoPucki, Arvin I. Abraham & Bernd P. Delahaye, *Optimizing English and American Security Interests*, 88 NOTRE DAME L. REV. 1785, 1800 (2013);

Walsh states further that the Article 9 deposit account regime is “increasingly promoted internationally as a comprehensive regime of security for movable assets”.⁴⁶ The UNCITRAL Legislative Guide on Secured Transactions is a reflection of this law and this is in the framework for laws that is seen as a model code for banks to secure collaterals in lending in assets. Under the Guide’s recommendations a secured creditor who obtains control of a deposit account has priority over a secured creditor who perfects its security right by registration even if registration preceded the obtaining of control.⁴⁷ The privileged status accorded to security rights perfected by control at the level of priority carries over to enforcement on default. If the secured creditor has control by virtue of its status as the depository bank, it may simply apply the funds credited to the deposit account to the obligation secured by the deposit account.⁴⁸ If the secured creditor is an outside creditor who has obtained control by virtue of a control agreement or because it has become the bank’s customer on the account, it may instruct the bank to pay the balance on deposit.⁴⁹

If, however, the secured creditor is relying on perfection by registration as opposed to control, it may enforce its security right only by obtaining a court order under Article 9 compelling the bank to pay the funds to it.⁵⁰ The secured creditor has no right to demand payment simply on notification to the bank. In contrast, the depository bank, in its capacity as secured creditor with automatic control, is entitled to simply pay itself out of the funds in the account, and outside secured creditors who have obtained

Jonathan C. Lipson, *Secrets and Liens: The End of Notice in Commercial Finance Law*, 21 EMORY BANKR. DEV. J. 421, 426 (2005).

⁴⁶ C Walsh supra 42, at 356

⁴⁷ Under Article 9, control is the only method available for perfecting a security right in a deposit account as original collateral: U.C.C. § 9-312(b)(1) (2014). However, a security right in a deposit account perfected by control may come into conflict with one perfected by registration where the deposit account is claimed as proceeds of collateral perfected by public registration pursuant to U.C.C. § 9-315(c) and (d). In that event, the security interest perfected by control has priority under U.C.C. § 9-327(1). Under the UNCITRAL Legislative Guide, while a security right in a deposit account may be made effective against third parties by registration even when the deposit account is original collateral (recommendation 49), the secured creditor who has obtained control has priority even against a prior registered secured creditor (recommendation 103). See UNCITRAL LEGISLATIVE GUIDE, UNCITRAL LEGISLATIVE GUIDE ON SECURED TRANSACTIONS: TERMINOLOGY AND RECOMMENDATIONS, U.N. Sales No. E.09.V.13 (2010), available at <http://www.uncitral.org/pdf/english/texts/security-1g/e/Terminology-and-Recs.18-1-10.pdf>

⁴⁸ U.C.C. § 9-607(a)(4) (2014).

⁴⁹ *Id.* at § 9-607(a)(5).

⁵⁰ *Id.* at § 9-607, cmt. 7.

control are likewise entitled to self-help collection rights without the need for judicial intervention.

The difference between the depository bank and outside secured creditors who seek to perfect a security right in a deposit account by control, is that the control regime privileges the depository bank. The depository bank is not obligated to enter into a control agreement with an outside secured creditor, even if its customer so requests, and even if it does not itself hold a security right in the account.⁵¹ If the bank does agree to enter into a control agreement, any security right the bank obtains in the deposit account has priority even if the control agreement was concluded before the bank acquired its security right.⁵² Therefore, the external secured creditor will also need to obtain the agreement of the depository bank to waive its priority.

The outside secured creditor can hypothetically be assured of priority over the depository bank by relying on the alternative method of control: becoming the bank's customer with respect to the deposit account.⁵³ This method of control gives it priority over any security interest acquired by the bank⁵⁴ and terminates the bank's set-off right for any claims it has against the debtor.⁵⁵ However, this method of control requires the cooperation of the bank, so in practice the bank's consent to waive its priority is needed.⁵⁶ This method of control is not considered to be viable for operating accounts to which the debtor needs regular access.⁵⁷

Walsh contends that "*the official justifications for the Article 9 control rules are not particularly convincing. With respect to the priority enjoyed by control secured creditors over those who have perfected by registration, the Official Comment*⁵⁸ *states that secured creditors "for whom the deposit account is an integral part of the credit decision will, at a minimum, insist upon the right to immediate access to the deposit*

⁵¹ *Id.* at § 9-342.

⁵² *Id.* at § 9-327(3).

⁵³ *Id.* at § 9-104(a)(3).

⁵⁴ *Id.* at § 9-327(4).

⁵⁵ *Id.* at § 9-340(c).

⁵⁶ See, e.g., Willa E. Gibson, *Banks Reign Supreme Under Revised Article 9 Deposit Account Rules*, 30 DEL. J. CORP. L. 819, 844 (2005).

⁵⁷ 29 Markell, *supra* note 6, at 987; see also G.R. Warner, *Deposit Accounts as Collateral under Revised Article 9*, AM. BANKR. INST. J. 18 (Aug. 2000).

⁵⁸ Bruce A. Markell, *From Property to Contract and Back: An Examination of Deposit Accounts and Revised Article 9*, 74 CHI.-KENT L. REV. 963, 966-67 (1999) at 987; see also G.R. Warner, *Deposit Accounts as Collateral under Revised Article 9*, AM. BANKR. INST. J. 18 (Aug. 2000).

⁵⁸ U.C.C. § 9-327, cmt. 3 (2014).

*account upon the debtor's default (i.e., control)" whereas those for whom the deposit account is less essential will not take control."*⁵⁹ The inference is that a secured creditor who demonstrates special reliance by taking the extra steps needed to obtain control should be rewarded for its efforts by a special priority.⁶⁰ This justification is premised on an inverted reasoning, since a secured creditor would not have to take these extra steps if priority were instead predicated on the basis of the order of registration of the security rights.

The priority generally held by the bank over outside secured creditors is interpreted by the Official Comment as a "rule of this kind enables banks to extend credit to their depositors without the need to examine either the public record or their own records to determine whether another party might have a security interest in the deposit account."⁶¹ There is implication that depository banks have a right superior to other suppliers of secured credit and in terms of the automatic control enjoyed by the depository bank by virtue of its status, the official comment implies that public notice is unnecessary since all actual and potential creditors are always on notice that the bank may assert a claim by virtue of its set off rights against the deposit account.⁶² The inference here is that awarding automatic control and a special priority to a depository bank's security right does not put third parties in a more disadvantageous position than they already occupy. The security interest is not subject to any public registration or other public notice requirement in the manner it is protected by Article 9.

The possibility exists for the bank to claim only obligations already owing to it by its customer at the time it receives notice of a competing claim.⁶³ The concept of automatic control, combined with the special priority accorded to the depository bank's security right displaces the need for the bank to first ascertain whether notice has been received before extending credit and eliminates the potential for litigation concerning the relative timing of the receipt of notice and the extension of credit.⁶⁴ The formulation of automatic control without the need for public notice cannot be explained simply as an objective application of the consequences of this trade off but as a privileged position of the bank's position relative to the set-off rights of other creditors.

⁵⁹ Walsh *supra* 42,46 at 358

⁶⁰ For an argument suggesting that this is the justification for control super-priority, see Randal C. Picker, *Perfection Hierarchies and Nontemporal Priority Rules* 74 CHI.-KENT L. REV. 1157 (1999).

⁶¹ U.C.C. § 9-327, cmt. 4 (2014).

⁶² *Id.* at § 9- 104, cmt. 3 ("No other form of public notice is necessary; all actual and potential creditors of the debtor are always on notice that the bank with which the debtor's deposit account is maintained may assert a claim against the deposit account.")

⁶³ See, e.g., CUMING, WALSH & WOOD, *supra* note 34, at 664

⁶⁴ See UNCITRAL LEGISLATIVE GUIDE, *supra* note 41, at 139, ¶ 144.

The Official Comment explains that the right of the bank to refuse to disclose whether control has been obtained by an outside secured creditor protects banks “from the need to respond to inquiries from persons other than their customers.”⁶⁵ However, in requiring external secured creditors to register notice of their security rights would equally relieve the bank from that burden while also serving to ensure public notice to competing creditors and other claimants.

Conclusion

Article 9 of the UCC has provided an interest for banks to become financial stakeholders in Secured Transactions and it protects the creditors who cover payment when there is a collateral on a debt or deposit account. The general rule on priority in real property security is that the first creditor to record its interest prevails over subsequent creditors. There are some exceptions; the most familiar is that the seller of a fixture on a purchase-money security interest has priority over a previously recorded mortgage. The court authorises the property sale in a judicial-sale foreclosure and no court approval is required. Once the property has been sold, it is deemed to belong to the new purchaser.

In about half the states in the US the mortgagor still has the right to redeem the property by paying up within six months or a year—the statutory redemption period. Thereafter, the mortgagor has no further right to redeem. If the sale proceeds exceed the debt, the mortgagor is entitled to the excess unless he has given second and third mortgages, in which case the junior mortgagees are entitled to recover their claims before the mortgagor. If the proceeds are less than the debt, the mortgagee is entitled to recover the deficiency from the mortgagor. However, some states have statutorily abolished deficiency judgments.

The banks have a direct interest in the Article 9 process as they are likely to be the secured creditors and they will be responsible for the credit for goods, services and mortgages to the mortgagee. They will also be able to enforce the foreclosure on the deposit accounts held in the names of the customers whose properties are secured. In all these circumstances the banks are expected to be acting in the capacity of the lender and to be assured of payment in case of insolvency and to retain a right as the priority creditor if the accounts are foreclosed..

⁶⁵ U.C.C. § 9- 342, cmt 2 (2014).