SECURITY INTERESTS IN BANK DEPOSITS
UNDER UCC article 9: A PERSPECTIVE

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PART I
INTRODUCTION

In the course of the 19th century, the process of the characterization of the bank deposit as a loan, so as to be owed by the banker to the customer as a debt on a loan, reached in the common law its logical conclusion.1 The landmark case is Foley vs Hill.2 In that case, the House of Lords dealt with the “common position of a banker … receiving money from his customer on condition of paying it back when asked…”3 Holding that “the banker is not an agent or factor, but [rather] he is a debtor”,4 Lord Cottenham spoke of the banker’s right to mix and use money deposited

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2 (1848), 2 HLC 28, 9 ER 1002. A slightly earlier authority is Pott vs Clegg, 1847, 16 M & W 321, 153 ER 1212.

3 Foley v Hill, ibidem, at 43 (HLC), 1008 (ER).

4 Ibidem, at 37 (HLC), 1006 (ER).
with him, subject to a repayment obligation of an equivalent sum, either with 
or without interest.

The analysis of the debtor and creditor relationship between the banker 
and customer was subsequently refined in Joachimson v Swiss Bank Corp.\(^5\)

The Court acknowledged that a sum of money held by the banker for 
the customer on a demand deposit forms a debt “owing or accruing”, al-
beit, in the absence of a demand properly made, “not presently payable”\(^6\) 
by the banker to the customer. As such, the deposit is garnishable by 
the customer’s creditors.\(^7\)

In the hands of a debtor, balance available on a deposit account\(^8\) held 
by that person is an item of property. Accordingly, the debtor may give it as 
security for credit extended to him or her by a third party. Funds deposited 
to secure an obligation are known to constitute “cash collateral”. The latter 
term is a misnomer; the ‘deposit’ is a debt owed by the depositary, whether 
or not it is a bank. It neither consists of ‘cash’, in the sense of coins and 
banknotes, nor is the ‘cash’ truly segregated.\(^9\)

As well, a bank\(^10\) extending credit to its customer may rely on a credit 
balance in the customer’s account with it. In each case, upon the account 
holder’s default on the credit contract, the creditor would like to be in a 
position to apply the credit balance in the deposit account towards the dis-
charge of the account holder’s indebtedness on the credit contract.

Various rights and devices exist to obtain priority in the balances of 
deposit accounts maintained by a defaulting account holder. This paper fo-
cuses on the security interest given by the customer either to the bank where 
the deposit account is maintained or to a third party. The discussion is on 
the priority among competing security interests and between a security in-
terest and other rights. Such rights may be of a garnishor seizing or assum-

\(^5\) 1921, 3 KB 110 (CA).

\(^6\) Terminology is, however, not always consistently used. Cf. e.g. the ambiguous use of 
the word ‘due’ as observed in Ontario Hydro-Electric Power Commission v Albright (1922), 
64 SCR 306, at 312: The word “due” in relation to moneys in respect of which there is a legal 
obligation to pay them may mean either that the facts making the obligation operative have 
come into existence with the exception that the day of payment has not yet arrived, or it may 
mean that the obligation has not only been completely constituted but is also presently exigible.

\(^7\) Supra, n. 5 at 131.

\(^8\) In this paper, unless specifically indicated otherwise, terms such as ‘deposit account’, 
‘bank deposit’, ‘balance due on the account’ and similar expressions are used loosely and 
interchangeably.

\(^9\) The origin of the term (in a different context and not identical sense) can be probably 

\(^10\) Unless otherwise indicated, ‘bank’ (or ‘banker’) loosely denotes any type of deposit-
taking institution, usually making loans and extending credit in its own name.
ing control of the account. Alternatively, they may be of the bank holding the account and seeking to combine the account in a credit position with another account in a debit position. In so combining accounts, the bank holding them purports to avoid the release of the funds in the account in credit to a third-party creditor of the customer, and rather, use them to satisfy the customer’s debt owed to the bank on the account in debit.

This paper explores from a Canadian perspective the provisions of article 9 of the Uniform Commercial Code as revised in 1999 as a model for reform for Canadian provinces and territories that adopted personal property security legislation. This legislation has not followed the 1999 UCC revisions. The perspective is particularly that of Ontario where a proposal for perfecting security interests in deposit accounts by control inspired by the 1999 US scheme is pending. The article is a sequel to an earlier one exploring at length the deficiencies of the current situation but does not touch upon any specific proposal for reform.

The paper proceeds as follows. Part II analyzes the statutory scheme under personal property legislation in Canada, particularly the one of the Ontario Personal Property Security Act (“OPPSA”). This statute, as others under this name in all common law provinces and territories, governs ‘secured transactions’, or more specifically, “security agreements” giving rise to “security interests” in personal property. Part III sets out the treatment of the subject

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12 Geva, B. “Rights in Bank Deposits and Account Balances in Common Law Canada”, 2012, 28, Banking and Finance Law Review. The two articles are of different scope and focus; nevertheless, some overlap is inevitable.
14 Term is not defined in the OPPSA which in principle is stated in section 2 to apply to: (a) every transaction without regard to its form and without regard to the person who has title to the collateral that in substance creates a security interest including, without limiting the foregoing; (i) a chattel mortgage, conditional sale, equipment trust, debenture, floating charge, pledge, trust indenture or trust receipt, and (ii) an assignment, lease or consignment that secures payment or performance of an obligation; (b) a transfer of an account or chattel paper even though the transfer may not secure payment or performance of an obligation; and (c) a lease of goods under a lease for a term of more than one year even though the lease may not secure payment or performance of an obligation.
15 Defined in OPPSA Section 1(1) to mean “an agreement that creates or provides for a security interest and includes a document evidencing a security interest”.
16 Defined in OPPSA Section 1(1) to mean “an interest in personal property that secures payment or performance of an obligation, and includes, whether or not the interest secures payment or performance of an obligation”.
17 Comprehensively defined in OPPSA Section 1(1) effectively to cover all items of property other than real property.
under the 1999 revisions of article 9 of the Uniform Commercial Code in the United States. Specifically these revisions introduced perfection by control and a new priority scheme.\footnote{Another noteworthy innovation, pointed out further below, is that of the coverage given to security interests in bank deposits in the first place. However, as also discussed further below, this has always been the legal position in Canada.} Part IV highlights the inadequacy of the present scheme and hence the need for reform. It briefly assesses the revised scheme under article 9 as a basis for statutory reform in Canada.

**PART II**

**THE SCHEME UNDER CANADIAN PERSONAL PROPERTY SECURITY LEGISLATION**

In the United States, former article 9 of the Uniform Commercial Code did not apply to the “transfer of an interest in any deposit account”,\footnote{Section 9-104[1], 1972.} thereby excluding security interests in deposit accounts serving as original collateral. At the same time, under the OPPSA, from its original adoption,\footnote{The Personal Property Security Act, RSO 1970, c 344.} a deposit account has fallen into the definition of ‘account’;\footnote{Defined in OPPSA Section 1(1) to mean “a monetary obligation not evidenced by chattel paper or an instrument, whether or not it has been earned by performance, but does not include investment property”.} in turn, ‘account’ is a species of ‘intangible’.\footnote{Defined in OPPSA Section 1(1) to mean “all personal property, including choses in action, that is not goods, chattel paper, documents of title, instruments, money or investment property”. “Account” is not excluded; hence it is included.} A security interest in an intangible is perfected by the registration of a financing statement.\footnote{OPPSA Section 23.}

In *Caisse populaire Desjardins de l’Est de Drummond v Canada*,\footnote{2009, 2 SCR 94.} the Supreme Court of Canada analyzed a contractual term under which a bank\footnote{Strictly speaking it was a Caisse Populaire, which is the equivalent of a credit union in Quebec.} took a security interest in a deposit account maintained with it.\footnote{See Binnie, Ian J., “Comment on Caisse populaire Desjardins de l’ Est de Drummond v Canada” (2011), 26 Banking and Finance Law Review 327. From a Quebec perspective see Deschamps, Michel “La compensation comme mécanisme de garantie et les sûretés sur les dépôts bancaires”, (2012) published in Lemieux, M., *Le Droit bancaire en 2011: nouveautés et tendances*, Les Éditions Thémis, 2012, at 1.} Considering the agreement as giving the Caisse a right over the customer’s property,\footnote{Drummond, supra, n. 24 at para 16.} the ma-
jority of the Supreme Court of Canada concluded that the agreement gave the Caisse a security interest in customer’s saving deposit. Effectively, this followed the English position under which it is feasible for a debtor, including a bank owing on a deposit account, to take a security interest in the very debt it owes.28 Thus, the deposit account is collateral available to both the bank owning it and any third party.

Under the OPPSA, the first to register obtains priority against any competing security interest.29 A notable exception is a holder of a “purchase-money security interest”, who must be either a seller of a deposit account (such as a seller of an already issued certificate of deposit) who takes a security interest in it “to secure payment of or part of its price” or who holds a security interest to secure value given “for the purpose of enabling the debtor to acquire rights in or to the deposit account to the extent that the value is applied to acquire such rights”.30 A holder of a “purchase-money security interest” in an intangible, which became perfected “before or within 15 days after its attachment”, has priority over any other security interest in deposit account.31 “Attachment” in the debtor’s hands consists of receiving value, having rights in the deposit account, and signing a security agreement adequately describing the deposit account.32 Between two unperfected security interests it is the first to attach which prevails.33

As well, until perfected, a security interest is defeated by “a person who causes the collateral to be seized through execution, attachment, garnishment … or other legal process”.35 An unperfected security interest is also defeated by a creditors’ representative such as a trustee in bankruptcy.36 The general principle is that of ‘first in time first in right’. However, a holder of a “purchase money security interest”, securing either the purchase price of the collateral or the loan that

28 Re Bank of Credit and Commerce International, n. 8, 1998, 1 AC 214 (HL), r’vsg, 1996 2 All ER 121 (CA) on this point and disapproving of Re Charge Card Services Ltd., 1986, 3 All ER 289 (Ch D).
29 OPPSA Section 30(1) Rule 1.
30 OPPSA Section 1(1).
31 OPPSA Section 33(2)(b).
32 OPPSA Section 11(2).
33 OPPSA Section 30(1) Rule 4. Under OPPSA Section 11(2), “attachment” consists of receiving value, having rights in the deposit account, and signing a security agreement adequately describing the deposit account.
34 In the context of an intangible, “perfection” requires both attachment and registration. OPPSA Section 19.
35 OPPSA Section 20(1)(a)(ii).
36 OPPSA Section 20(1)(b).
funded the payment for it,\textsuperscript{37} prevails over a seizing or garnishing creditor as well as a creditors’ representative such as a trustee in bankruptcy even if perfected after seizure or bankruptcy, as long as perfection by registration occurs “before or within 15 days after … attachment”.\textsuperscript{38} A seizing or garnishing creditor will defeat an optional future advance by a holder of a perfected security interest, who received a written notification of the seizure or garnishment.\textsuperscript{39} No specific priority is accorded to a bank, which holds a security interest in a deposit account held on its books.

Under OPPSA Section 25(1), “[w]here collateral gives rise to proceeds, the security interest therein … (b) extends to the proceeds”. Under OPPSA Section 25(3), “A security interest in proceeds is a continuously perfected security interest if the interest in the collateral was perfected when the proceeds arose”. Both perfection and its priority in original collateral are carried over to the proceeds. The continued priority of a purchase-money security interest holder in the proceeds of the original collateral is specifically provided for.\textsuperscript{40}

As defined in OPPSA Section 1(1), “proceeds” are “identifiable or traceable personal property\textsuperscript{41} in any form derived directly or indirectly from any dealing with collateral or the proceeds therefrom”. As a matter of general law, funds derived from the sale of the original collateral deposited to a segregated ‘proceeds’ account are “identifiable” proceeds under the common law.\textsuperscript{42} At the same time, funds derived from the sale of the original collateral deposited to a general account and mixed with other funds of the debtor may be “traceable” in equity.\textsuperscript{43} By reference to this, the cumulative effect of OPPSA Section 25(1) and (3) is that the existence, perfection and priority of a security interest in an original collateral are carried also to its “identifiable” and “traceable” proceeds in the form of funds deposited in the debtor’s bank accounts. In principle, on that count, the OPPSA follows suit article 9 of the Uniform Commercial Code.\textsuperscript{44}

OPPSA Section 25(1)(a), provides that where “the secured party expressly or impliedly authorized the dealing with the collateral free of the

\textsuperscript{37} See definition in OPPSA Section 1(1).
\textsuperscript{38} OPPSA Section 20(3)(b).
\textsuperscript{39} OPPSA Section 30(4).
\textsuperscript{40} See Section 33(1) and (2), respectively for proceeds of inventory and other collateral.
\textsuperscript{41} For the definition of “personal property” under the OPPSA, see, supra, n. 17.
\textsuperscript{42} See e. g. Canadian Western Millwork Ltd v Royal Bank of Canada, 1964, SCR 631.
\textsuperscript{43} See e. g. Flexi-Coil Ltd v Kindersley District Credit Union Ltd., 1993, 107 DLR (4th) 129 (Sask CA).
\textsuperscript{44} See in general UCC Section 9-315 in conjunction with Section 9-102(a) (64). Unless indicated otherwise, all UCC references are to the 1999 Official Text.
security interest”, a transferee, even with knowledge of the security interest, takes the collateral free of the security interest. Even in the absence of such authorization, a bona-fide payee may be protected under general rules conferring a ‘currency’ quality on ‘bank money’.45 However, protection provided by the ‘currency’ quality of ‘bank money’ may not be comprehensive. Protection may even not be accorded to a taker of cash collateral deposited to the taker’s own account competing with a secured creditor of the debtor with an earlier registration. This is so since the ‘transfer’ or the deposit of funds of which the cash collateral consists is not ‘payment’46 but rather a transaction intended to secure the debtor’s obligation to the taker of the cash collateral.47 As such it is covered by the OPPSA and triggers its priority scheme. Particularly, an earlier registrant claiming under a security agreement covering either the source of the funds or the debt of which they consist will claim priority over the taker of the cash collateral.48 In some cases, priority may be accorded to a secured party tracing the proceeds of collateral in which the secured party has a purchase money security interest priority.49

A conflict may arise between a holder of a security interest in a deposit account and the deposit holding bank’s right to withhold payment on the basis of a contractual set-off. Setting aside funds as collateral from a deposit account in the debtor’s name to secure the debtor’s obligation is in the form of an assignment of a credit balance. Thus, in principle,50 both absolute trans-

45 For a general discussion see Crawford, Bradley, *The Law of Banking and Payment in Canada*, vol 1, Toronto, Canada Law Book, Looseleaf-updated to December 2011, at para. 3:20.10(2), 3:30.10 and 3:40.10(4)(d)(i). This conclusion is also drawn from R v Canadian Imperial Bank of Commerce, 2000, 51 OR (3d) 257 (CA); Bank of Montreal v iTrade Finance Inc, 2009 ONCA 615, 252 OAC 291; Indian Head Credit Union v Andrew, 1992, 97 DLR (4th) 462 (Sask CA); Transamerica Commercial Finance Corp, Canada vs. Royal Bank of Canada, 1990, 70 DLR (4th) 627 (Sask CA); Flexi-coil Ltd v Kindersley District Credit Union Ltd, 1993, 107 DLR (4th) 129 (CA). For a recent American case (citing earlier authorities) on the point see Variety Wholesalers v Salem Logistics Traffic Services, 723 SE 2d 744, NC SC, 2012.

46 So as to benefit a bona fide payee, *Idem*.

47 For the scope of the OPPSA to cover such a transaction, see OPPSA Section 2(a).

48 For the priority of the first to register under OPPSA Section 30(1) Rule 1, see text, supra, and n. 29.

49 The priority of a holder of a purchase security interest in both in the original collateral and its proceeds is provided for in OPPSA Section 33.

50 Exceptions are set out in OPPSA Section 4(1), providing that the Act does not apply, particularly as follows:

(c) to a transfer of an interest or claim in or under any policy of insurance or contract of annuity, other than a contract of annuity held by a securities intermediary for another person in a securities account;(g) to a sale of accounts or chattel paper as part of a transaction to which the Bulk Sales Act applies;
fers and transfers intended for security of “accounts”, including deposit accounts and other balances due from banks, are governed in common law Canada by personal property security legislation.51

The assignment of a debt does not prejudice the debtor on the assigned debt, frequently referred to as the “account debtor”52 so as to distinguish that person from the assignor, who is the debtor in the transaction in which the assigned debt is the collateral.53 “The assignee … can acquire no greater rights under the assignment than those enforceable by the assignor, and he therefore, takes subject to all defences existing in respect of the right assigned which would be available against the assignor seeking to enforce the rights assigned”.54 This principle, originally enunciated for equitable assignments,55 was specifically codified for statutory assignments, describing the assignee’s position as “subject to all equities” as “if this section had not been enacted”.56 In the footsteps of the earlier version of UCC Section 9-318(1) in the United States,57 personal property security legislation in Canada, particularly as clarified recently by a new OPPSA Section 40(1.1),58 is to the same effect.

Exercised as a contractual set-off, the combination of accounts by the bank is a defence available against a secured party/assignee. Thus, as against a pre-assignment contractual right of set-off, a holder of a security interest

(h) to an assignment of accounts made solely to facilitate the collection of accounts for the assignor; or

(i) to an assignment of an unearned right to payment to an assignee who is to perform the assignor’s obligations under the contract.

51 OPPSA Section 2(a) and (b).
52 See e.g. definitions in OPPSA Section 40(1) and UCC Section 9-102(a)(3).
53 See definitions of “debtor” in OPPSA Section 1(1) and UCC Section 9-102(a)(1)(28)(B).
55 Equitable assignments are discussed in Chapter 4 of Tolhurst, Greg, The Assignment of Contractual Rights, Oxford and Clarendon Oregon, Hart, 2006. Equitable assignment need not be absolute; it may be by way of charge also as a matter of form. As well, it is effective to transfer title to the assignee regardless of the lack of notice to the debtor. See Gorringe v Irwell India-Rubber and Gutta-Percha Works, 1885, 34 Ch D 128.
56 The original provision is Section 25(6) of the English Judicature Act, 1873 (UK), 36 & 37 Vict 66. The present provision to that effect in England is Section 136 of the Law of Property Act, 1925 (UK), Chapter 20, 15 & 16 Geo 5. In Ontario, it is Section 53(1) of the Conveyancing and Law of Property Act, RSO 1990, c C.34. Statutory assignment must be absolute in writing, of the whole balance, and of which express notice in writing is given to the debtor, Idem.
57 Official Texts of 1962 and 1972. The present statutory provision in the United States, Official Text, 1999, is UCC article 9-404 which is almost verbatim.
58 2006, c 34, Sched E, s 11 (1).
in the deposit account is defeated by the deposit holding bank. This is so even where the security interest is perfected. At the same time, post-assignment contractual right of set-off is an unwarranted modification of the assigned contract which may not be raised against the assignee.\(^{59}\)

In the absence of contractual set-off, there is no unanimity in the scholarly view in Canada on the priority of the bank’s right to combine accounts.\(^{60}\) At one end of the spectrum, Cuming asserts that “the rules of equitable set-off provide the most consistent and practical” solution so as to protect the bank combining accounts only when it acts without knowledge.\(^{61}\) At the other end of the spectrum, Crawford is of the view that the bank’s right to combine accounts, being “inherent in the banker-customer relation in the common law” necessarily prevails regardless of other considerations.\(^{62}\)

Equitable set-off is exercised by the assertion “as a defence to [an] action” of “grounds… which (prior to the Judicature Act) would have entitled a defendant to file a bill in Chancery to restrain the plaintiff from proceeding with his action…”\(^{63}\) Such grounds are based on the breach of a duty arising from a contract sued upon or a matter closely related to it.\(^{64}\) Hence, I find ‘equitable set-off’ to be irrelevant. At the same time I am persuaded neither by the “inherent nature” of the bank’s right nor by its alleged reach. In my mind the resolution of the set-off priority issue depends on the nature of the banker’s right to combine accounts. I thus argue that as long as it is treated as a right of set-off operating like a legal set-off,\(^{65}\) and other than

\(^{59}\) OPPSA Section 40(3).


\(^{62}\) Crawford, supra, n. 45 vol 2 at § 9:60.20(6)(b).

\(^{63}\) Bankes vs. Jarvis, [1903] 1 KB 549, at 552.

\(^{64}\) See Hanak vs. Green, [1958] 2 QB 9 (CA), at 24, where “[t]here was a close relationship between the dealings and transactions which gave rise to the respective claims”. Damages suffered by the debtor caused by the breach, whether in a liquidated or unliquidated amount, to which the debtor is entitled at the time of the action, may then be set off against the sum claimed by the creditor. The effective exercise of the equitable set-off by the defendant results in the reduction of the amount owed by the defendant-debtor to the plaintiff-creditor. Reduction is by the amount of damages stemming from the breach by the plaintiff-creditor of a duty flowing out and inseparably connected with the same contract.

\(^{65}\) Both Baker vs. National City Bank, 511 F2d 1016, 1018 (6th Cir 1975) and UCC Section 4-303(a) support this understanding of the bank’s right to combine account.
where it could benefit from the authority given by the secured party to the
customer to dispose of the collateral free of the security interest, the bank’s right to combine accounts, is defeated by a security interest. At the same time, where it is characterized as a current account set-off, the banker’s right to combine accounts defeats a competing security interest. I suppose that the result does not depend on whether the security interest is perfected. It is only as a current account set-off the right to combine accounts is “inherent in the banker-customer relation” so as to prevail over all adverse claims.

A bank combining accounts, even if it is to be considered as a lien holder, does not qualify under OPPSA Section 31 as “a person [who] in the ordinary course of business furnishes materials or services with respect to goods that are subject to a security interest”. Under that provision, such a person defeats even a perfected security interest. At the same time, under OPPSA Section 20(1)(a)(i) an unperfected security interest is subordinate to “the interest of … a person who … has a lien given under any other Act or by a rule of law or who has a priority under any other Act”. While no “other Act” specifically gives priority to the right to combine accounts, priority is given under OPPSA Section 20(1)(a)(i) to “a lien given under … a rule of law”. Priority continues only until the security interest is perfected. It follows that other than in circumstances governed by OPPSA Section 31, a perfected security interest defeats a lien. Thus, if it is a lien, the bank’s right to combine accounts defeats an unperfected security interest. At least as long as the debtor/customer is not authorized to dispose of the proceeds free of the security interest, the lien is defeated by a perfected security interest. I suppose that as a lien the bank’s right to combine accounts also defeats garnishment.

67 See text, supra, n. 62.
69 OPPSA Section 31 reads in full as follows:
Where a person in the ordinary course of business furnishes materials or services with respect to goods that are subject to a security interest, any lien that the person has in respect of the materials or services has priority over a perfected security interest unless the lien is given by an Act that provides that the lien does not have such priority.
70 Under OPPSA Section 25(1), the security interest survives the unauthorized disposition.
SECURITY INTERESTS IN BANK DEPOSITS UNDER UCC

PART III

THE SCHEME UNDER REVISED UCC ARTICLE 9

I. COVERAGE

The priority scheme under article 9 of the American Uniform Commercial Code ("UCC article 9") is fundamentally the same as in Canadian provincial personal property security legislation. Since the former inspired the latter, this is of course neither surprise nor coincidence. Briefly stated, a garnishor, a creditor’s representative such as a trustee in bankruptcy, or a perfected security interest holder defeats an unperfected security interest.71 Perfection of a security interest in accounts and general intangibles72 is by filing.73 Between two perfected security interests the first to file prevails.74 Otherwise, between two unperfected security interests, the first to attach gets the priority.75 Attachment requires value to be given and the debtor to have rights in the collateral and sign a security agreement.76 Finally, super-priority is accorded to a holder of timely perfected purchase-money interest,77 in the deposit account to the extent of properly ‘identifiable or traceable’ proceeds deposited in it.78

However, in contrast to Canada, previous versions of article 9 did not cover the deposit account as original collateral. This omission proved to be unfortunate.79 Accordingly, in 1999 UCC article 9 was revised to provide for

71 UCC Sections 9-317(a)(2) and 9-322(a)(2).
72 Respectively defined in UCC Section 9-102(a)(2) and (42).
73 UCC Section 9-310. ‘Filing’ under the UCC is the same as ‘registering’ under personal property security legislation.
74 UCC Section 9-322(a)(1).
75 UCC Section 9-322(a)(3).
76 UCC Section 9-203.
77 See definitions of “purchase-money security interest” and “proceeds” in UCC Sections 9-103(b) and 9-102(a)(64). In principle these definitions are similar to those under the OPPSA set out in, supra, Part II.
78 The “purchase-money security interest” priority in original collateral and proceeds is governed by UCC Section 9-324.
a specific scheme\textsuperscript{80} for the perfection (other than by filing or registration), priority,\textsuperscript{81} and enforcement\textsuperscript{82} of a security interest\textsuperscript{83} in a debt owed by a bank for funds or monetary value credited to a deposit account.\textsuperscript{84} The collateral\textsuperscript{85} is treated as “deposit account”;\textsuperscript{86} it is a distinct category of collateral that is specifically excluded from the definition of “general intangible”.\textsuperscript{87} A security agreement purporting to cover it must reasonable identify it.\textsuperscript{88}

“Deposit account” is defined in UCC Section 9-102(a)(29) to mean “a demand, time, savings, passbook, or similar account\textsuperscript{89} maintained with a bank”.


\textsuperscript{81} Under UCC Section 9-304(a), it is “The local law of a bank’s jurisdiction [which] governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a deposit account maintained with that bank”. Rules determining that jurisdiction are provided in UCC Section 9-304(b). Briefly stated, these rules determine the law applicable according to enumerated factors, i.e., the parties’ agreement, and in its absence, the location of “the office identified in an account statement as the office serving the customer’s account is located”, or, as a last resort, the location of “the chief executive office of the bank”.

\textsuperscript{82} The secured party’s right to apply the balance of the deposit account to the secured obligation or instruct the bank to pay for its benefit is provided for in UCC Section 9-607(a).

\textsuperscript{83} Broadly defined in UCC Section 1-201(b)(35) to be “an interest in personal property… which secures payment or performance of an obligation”.

\textsuperscript{84} For the debt relationship created by the deposit of money with a banker, see Foley v Hill (1848), 2 HLC 28, 9 ER 1002. The case is discussed above in Part II.

\textsuperscript{85} Under UCC Section 9-102(a)(12), “collateral” is defined to mean “the property subject to a security interest …”.

\textsuperscript{86} Principal provisions are listed in Official Comment 16 to UCC Section 9-109.

\textsuperscript{87} See UCC Section 9-102(a)(42). Accordingly, “a security agreement covering general intangibles will not adequately describe deposit accounts”. Official Comment 16 to UCC Section 9-109. “General intangible” is the residual category of personal property “that is not included in the other defined types of collateral”. See Official Comment 5(d) to UCC Section 9-102.

\textsuperscript{88} As required in UCC Section 9-108. See Official Comment 16 to UCC Section 9-109. Note that under UCC Section 9-108(c), a supergeneric description, such as “all the debtor’s assets” or “all the debtor’s personal property”, “does not reasonably identify the collateral”.

\textsuperscript{89} In principle, under UCC Section 9-102(a)(2), “account” is defined to mean “a right to payment of a monetary obligation, whether or not earned by performance”. Cf. the narrower definition in UCC Section 4-104(a)(1) under which “account” is defined to mean “any
Investment property or accounts evidenced by an instrument are specifically excluded. In turn, “bank” is defined in UCC Section 9-102(a)(8) to mean “an organization that is engaged in the business of banking” so as not to be limited to commercial banks, but rather to include also “savings banks, savings and loan associations, credit unions, and trust companies”. Effectively, this means a deposit account covered by article 9 may be maintained with any deposit-taking institution. However, other than with respect to proceeds and priorities therein, article 9 does not apply to “an assignment of a deposit account in a consumer transaction”. The latter are defined to mean “a transaction in which (i) an individual incurs an obligation primarily for personal, family, or household purposes, (ii) a security interest secures the obligation, and (iii) the collateral is held or acquired primarily for personal, family, or household purposes…”.

II. Perfection

Other than in connection with proceeds of collateral deposited into a deposit account, “a security interest in a deposit account may be per-
fected only by control”. Under UCC Section 9-314(b), it “is perfected by control … when the secured party obtains control and remains perfected by control only while the secured party retains control”. Requirements for control of a deposit account are set out in UCC Section 9-104(a), under which:

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.

Under UCC Section 9-342, a bank is not required to enter into a control agreement “even if its customer so requests or directs”. This acknowledges that the exclusion of perfection by registration (as opposed to its subordination to a security interest perfected by control) seems to me unjustifiable.

The duty to terminate control where “there is no outstanding secured obligation and the secured party is not committed to make advances…” is governed by UCC Section 9-208.
edges the bank’s rights with respect to the deposit and recognizes its discretion in carrying out its business. Furthermore, under that section, “A bank that has entered into such an agreement is not required to confirm the existence of the agreement to another person unless requested to do so by its customer”. This is consistent with UCC Section 9-210 under which only the secured party is under an obligation to provide information regarding the collateral; it is obliged to do so only to the debtor, with whom alone a third party is supposed to inquire. In any event, as indicated, Section 9-342 nevertheless obliges the bank to confirm the existence of a control agreement to a third party when it is “requested to do so by its customer”.

Surely, the secured party’s ‘control’ may be exclusive, so as to relate to a blocked account from which the debtor is not allowed to withdraw. At the same time, ‘control’ needs not necessary be exclusive, and may be shared with the debtor. There is no requirement for the “absolute dominion to the exclusion of the debtor”.105 Rather, according to UCC Section 9-104(b).

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.

Stated otherwise, ‘control’ can even be exercised over an operational account, from which the debtor is allowed to withdraw. Moreover, ‘control’ may be given on a standby basis, under an arrangement that does not allow the interference by the secured party in the everyday running of the account in the ordinary course of business. Accordingly, from a strictly legal perspective, “control” includes ‘the right to control’; the latter is very much like the secured party’s right under the English ‘floating charge’ on assets of a going concern, as well as under the modern ‘floating lien’ on inventory and other secured assets that a debtor is free to dispose of in the ordinary course of business, free of the security interest.106

Thus, where the secured party has a ‘mere’ right to control, the debtor carries on his or her business as usual, fully exercising dominion over the deposit account, until actual ‘control’ is assumed by the secured party, as in ‘crystallization’ in the English ‘floating charge’.107 Depending on the control agreement, such could be the case in each of the options enumerated in UCC Section 9-104(a), namely, whether the secured party (i) is the bank

105 Official Comment 5 to UCC Section 9-312.
106 For the floating charge see in general Governments Stock & Other Securities Investment Co vs. Manila Ry Co, 1897, AC 81 at 86. For the floating charge not being a “specific mortgage of … assets, plus a licence … to dispose of them” see Evans vs. Rival Granite Quarries, Ltd., 1910, 2 KB 979 at 999 (CA).
107 Idem.
on whose books the deposit account is maintained, (ii) became a customer of the bank with respect to the deposit account, or (iii) otherwise became a party to a control agreement with the debtor and the bank.\textsuperscript{108}

### III. Priority Rules

Priority of security interests in a deposit account is provided for in UCC Section 9-327 and can be summarized as follows:

1. A secured party who has control defeats any other secured party.\textsuperscript{109} In light of UCC Section 9-312(b), stating that “a security interest in a deposit account may be perfected only by control”,\textsuperscript{110} the competing secured party, to be defeated, may have had an unperfected security interest or be a proceeds claimant, even with a perfected security interest.\textsuperscript{111}

2. Among secured parties who have control, the following rules apply:
   a. A secured party who became the bank’s customer with respect to the deposit-account prevails over the bank with which the deposit account is maintained;\textsuperscript{112}
   b. Otherwise, “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”;\textsuperscript{113} and
   c. In all other cases, “security interests perfected by control … rank according to priority in time of obtaining control”.\textsuperscript{114}

With respect to the debtor’s deposit account, the super-priority of the bank where the account is maintained is rationalized in Official Comment 4 to Section 9-327 as a means to enable “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”. In releasing a bank from the onus of examining their own records, this rationale appears to go too far; and yet it is also too

\textsuperscript{108} UCC Section 9-104(a). See text, supra, that follows n. 100.

\textsuperscript{109} Subsection (1).

\textsuperscript{110} Emphasis added; see text, supra, and notes 97-99.

\textsuperscript{111} For the perfection and priority of a security interest in “identifiable or traceable” proceeds placed in a deposit account see, supra, nn. 77-78 and 97.

\textsuperscript{112} Subsection 4. Note, however, that the provision does not state that such a secured party prevails over an earlier secured party other than the bank with which the deposit account is maintained.

\textsuperscript{113} Subsection 3.

\textsuperscript{114} Subsection 2.
narrow in not mentioning the advantage to the customer in having its bank more ready to extend credit.

Protection from the super-priority of the bank where the deposit account is maintained can be achieved by a secured party becoming “the bank’s customer with respect to the deposit account” under UCC 9-104(3). As well, a secured party may obtain from the bank a subordination agreement as permitted by UCC Section 9-339. Also, “A secured party who claims the deposit account as proceeds of other collateral can reduce the risk of becoming junior by obtaining the debtor’s agreement to deposit proceeds into a specific cash-collateral account and obtaining the agreement of that bank to subordinate all its claims to those of the secured party.” Finally, a proceeds claimant can also require a debtor to pay directly to an account under the secured party’s control.

Priority accorded to a secured party in a deposit account, including the bank where it is maintained, is however not without exception. Thus, UCC Section 9-332(b) “affords a broad protection to transferees who take funds from a deposit account ..”. Thereunder, 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.

Citing a policy enhancing “the free flow of funds” the provision does not require the transferee to be without knowledge, to give value, or even to satisfy a reliance requirement. Only a transferee acting in collusion with the debtor is deprived of the protection, which is not conferred on the debtor attempting to move funds from one account to another. Rather, the provision affords protection exclusively to a ‘non-colluding’ third-party transferee, namely a ‘non-colluding’ payee, of funds out of the deposit account.

115 See text, supra, around nn. 104-105.
116 Official Comment 4 to Section 9-327.
117 Per UCC Section 9-104(a)(3). See text, supra, at nn. 104-115.
118 Official Comment 2 to UCC Section 9-332.
119 For these points see Official Comments 2-3 to UCC Section 9-332. The quote is from Official Comment 3.
120 Strictly speaking, a funds transfer is not a transfer. Rather, it is the extinction [or reduction in the amount of] of a debt owed to one person and its replacement by [or increase in the amount of] another debt owed to another person. A leading modern case to that effect is Libyan Arab Foreign Bank vs. Banker’s Trust Co, 1988, 1 Lloyd’s Rep 259, at 273 (QB), specifically rejecting “dicta in one American case” to the contrary, apparently from Delbrueck vs. Manufacturers Hanover Trust Co, 609 F 2d 1047, at 1051 (2nd Cir. 1979).
121 “Bad actors” and “transferee who does not take free” are respectively discussed in Official Comments 4 and 5 to UCC Section 9-332.
Since control trumps all other modes of perfection, control would have defeated perfection by registration. This would have been so regardless of the knowledge of the competing registration by the secured party taking control. Such would have been the case had there been perfection by registration for a deposit account as original collateral. This would be consistent with the principle that unless stated otherwise for a specific rule, knowledge does not play a role in the priority scheme under article 9. For sure then, a secured party taking control of a bank deposit beats an earlier unperfected security interest in the deposit account, regardless of knowledge. However, where funds deposited in a deposit account subject to control, are impressed with trust, a security interest, or otherwise an adverse claim, the analysis differs. Certainly, the secured party assuming control will defeat a security interest in the funds that was created under a security agreement authorizing the debtor to dispose of them free of the security interest. Otherwise, the secured party assuming control may be protected, at least as against a holder of a security interest in the funds, as a non-colluding transferee of funds under UCC Section 9-332(b). As against another adverse claim, protection is under general principles of law, arguably in circumstances requiring lack of knowledge.

Nonetheless, “the free flow of funds through the payment system” purports also to underlie the rule provided for in UCC Section 9-341. Thereunder, in principle, “a bank’s rights and duties with respect to a deposit account maintained with the bank” are “unaffected by the creation or perfection of a security interest or by the bank’s knowledge of the security interest”.

This general rule of UCC Section 9-341 is stated in the Section to be subject to two exceptions:

122 See e.g. UCC Sections 9-317(b), buyer receiving delivery, and 9-323(b)(1) (in connection with future advances).
123 See e.g. UCC Section 9-322 (Residual priorities rule).
124 For the disposition of collateral free of the security interest, see UCC Section 9-315(a)(1).
125 See e.g. Greenwood Teale (T & H) v William Williams, Brown & Co (1894), 11 TLR 56.
126 Official Comment 2 to UCC Section 9-341.
127 Official Comment 2, idem, acknowledges UCC Section 4-303(a) dealing with the time notice to the bank concerning a competing interest becomes effective. However, the Official Comment goes on to provide that UCC Section 4-303(a) “does not determine whether a timely notice is otherwise effective” and thus does not provide for the effectiveness of knowledge in circumstances governed by UCC Section 9-341. Rather, UCC Section 4-303(a) deals with the ineffectiveness of notice received after the bank acted to the contrary. It ought not necessarily to be read as providing for its effectiveness prior to that.
1. The first exception relates to circumstances governed by UCC Section 9-340(c), under which the exercise by the bank of a set-off against a deposit account is ineffective against a secured party who is the account holder. Such is the case (in which the bank’s right of set-off against the debtor is defeated) where the secured party obtained control of the deposit account by becoming “the bank’s customer with respect to the deposit account” under UCC Section 9-104(a)(3).128

2. The second exception pointed out in UCC Section 9-341 is where “the bank otherwise agrees in an authenticated record”. Only in both such cases the rights of the bank in which the deposit account is maintained are affected by the creation, perfection or knowledge of a security interest as well as instructions given to it by the secured party. Otherwise, under Official Comment 3 to UCC Section 9-341, until the bank is served with judicial process, or until it receives instructions with respect to the fund on deposit from a secured party in control, the bank is entitled to follow the debtor-customer’s payment instructions.

According to Official Comment 2 to UCC Section 9-341, this means that the bank may “ignore the instructions of the secured party unless it had agreed to honor them or unless other law provides to the contrary”. However, this language goes beyond a restatement of the two exceptions premised on the agreement of the bank; rather, it adds a third exception to the general rule of UCC Section 9-341, that of “another law provid(ing) to the contrary”. This third exception is elaborated by Official Comment 4 to UCC Section 9-341, effectively explaining that lack of termination, suspension or modification of a bank’s rights by the creation, knowledge, or receipt of instructions with respect to a security interest in a deposit account, is only so far as article 9 is concerned. At the same time, Official Comment 4 explains, possibly depending at least in part on whether the secured party has control and on the manner in which it was achieved, “whether a bank that pays out funds from an encumbered deposit is liable to the holder of the security interest” may be determined according to a rule derived from a non-uniform state law. Such a rule, “[o]ften… found in a non-UCC adverse claim statute”, “applies generally when a bank pays out funds in which a third party has an interest”.

I am perplexed by this third exception, that of another “law provid(ing) to the contrary”, per Official Comment 2. In elaborating on this exception, Official Comment 4 refers to “a non-UCC adverse claim statute” and to the scope and contents of a control agreement. The rule is, however,

128 See text, supra, at nn. 104 and 105.
possibly narrowed down by Official Comment 3, insofar as it requires the service of judicial process. Yet, as an alternative, without the further elaboration of the scope and contents of the exception as in Official Comment 4, Official Comment 3 points at the receipt of instructions from a secured party in control, as something that precludes the bank from complying with the account holder’s instructions.

Indeed, that the scope of this third exception is not adequately clear. Furthermore, whatever its scope, the exception is not mentioned in UCC Section 9-341. For sure, rules governing the position of a bank in which a deposit account is maintained and which is advised of a third-party’s adverse claim to the deposit account exist outside article 9. Thus, under the common law, generally speaking, a bank with knowledge of an adverse claim has lost its right to set-off the amount reflecting the claim against a debt due from the customer to the bank. However, according to “a growing number of jurisdictions” in the United States, the bank is precluded from exercising its set-off right even when the bank acts without knowledge of an adverse claim by a secured party as long as the bank did not suffer a detrimental loss. As well, under the common law, the bank is released from its duty to comply with payment instructions given by the customer/account holder to pay out of the deposit account, where these instructions conflict with the claim to the funds by the adverse claimant, who could be a secured party, who instructs the bank to either freeze the account, or transfer funds to him or her. Rather, the bank should file an interpleader action, or give a reasonable time to the adverse claimant to file his or her claim. In most jurisdictions in the United States, an ‘adverse claim’ statute gives the bank further protection by allowing it to ignore the adverse claim in two situations. The first one is where the bank has not been served with a court order restraining it from complying with its customer instructions. The second situation is where the bank accepted from the adverse claimant what the bank considers to be an adequate indemnity against liability to the customer.

129 See, supra, n. 126.
131 For a succinct discussion of adverse claims to a deposit account – both under the common law and adverse claims statutes, see e. g. B. Clarke, Barkley and Barbara, The Law of Bank Deposits, Collections and Credit Cards, Volume I, Revised Edition, Arlington, Va. Pratt, Updated through December, 1999, at 3.09.
Certainly, upon the default of the customer-account holder on the security agreement, the secured party, as an adverse claimant, may pursue the issuance of a restraining order against the bank. UCC Section 9-341 ought not to be read as precluding this, even in the absence of an agreement between the bank and the secured party. In fact, I would have read UCC Section 9-341 to be a uniform ‘adverse claim statute’ on its own so as to displace and supersede any non-uniform state law, whether or not embodied in an ‘adverse claim statute’.\(^\text{132}\) Hence I find the reference to “another law provid(ing) to the contrary”, per Official Comment 2, as elaborated by Official Comment 4 by reference to non-article 9 law, to be perplexing.

In any event, other than in the unusual case where the bank in which the deposit account is maintained breaks its agreement to comply with a secured party’s instructions, the power of a secured party to seek the issuance of a restraining order against that bank is relevant only in limited circumstances. This power may be used by a holder of a security interest that is junior to a security interest perfected:

i. by a secured party becoming a customer,

ii. by a secured party entitled under the control agreement with the bank to direct payments out of the deposit account of the customer (being the secured party’s debtor), or

iii. by the bank maintaining the deposit account.

Circumstances where such a power is to be invoked are likely to arise only infrequently; this is so since perfection of a security interest in a deposit account can be accomplished only by means of control,\(^\text{133}\) which in turn, requires the consent of the bank maintaining the deposit account.\(^\text{134}\) A prudent bank is likely to have the conditions for complying with the secured party’s instructions specifically stated in the agreement with the secured party. A dispute among competing secured parties in control, in which resort to the issuance of a restraining order may also be made, is therefore equally likely to be rare. It is thus particularly a holder of an unperfected security interest, who may resort to the issuance of a restraining order, usually with no real benefit, due to the junior position of the security interest.\(^\text{135}\)

\(^{132}\) Cf. UCC Section 1-103(b), addressing the possible displacement “by the particular provisions” of the UCC of contrary “principles of law and equity.”.

\(^{133}\) UCC Section 9-312(b)(1). See text, supra, & nn. 97-99 and 111.

\(^{134}\) UCC Section 9-104(a). See text, supra, at nn. 101-105.

\(^{135}\) For the junior position of an unperfected security interest in relation to a perfected one and a ‘lien creditor’ (defined in UCC Section 9-102(a)(52) to include an enforcing judgment creditor and a trustee in bankruptcy), see respectively, sections 9-322(a)(2) and 9-317(a)(2)(A).
IV. RECOUPMENT AND SET-OFF

“Security interest” in a “deposit account” governed by article 9 is to be distinguished from “a right of recoupment or set-off”. With respect to both these rights, article 9 does not apply, other than in two cases. The one relevant for our purposes, discussed immediately below, is “with respect to the effectiveness of rights of recoupment or set-off against deposit accounts” governed by UCC Section 9-340.

UCC Section 9-340 resolves the conflict between a security interest in a deposit account and the rights of recoupment and set-off of the bank maintaining the deposit account. It contains two rules, each applicable other than where the deposit account is in the name of the secured party.

First, subsection (a) states, “a bank with which a deposit account is maintained may exercise any right of recoupment or set-off against a secured party that holds a security interest in the deposit account”. This means that in case of a contest between the bank maintaining the deposit account and a secured party, priority is conferred on the bank’s right of recoupment or set-off; the secured party takes the deposit subject to the rights of the bank. At least for recoupment, this is quite logical; as collateral, the deposit

136 ‘Recoupment’ is American law term meaning the right of a defendant in a lawsuit to demand deduction from the amount awarded to plaintiff of a sum due the defendant from the plaintiff in the transaction which was the subject of the lawsuit. See e. g. Black’s Law Dictionary s. v. “recoupment” and s. v. “equitable recoupment”. It roughly covers ‘abatement’ and ‘equitable set-off’ in Anglo-Canadian law. In the common law, under the doctrine of abatement, damages resulting in the diminution of the value of the subject matter may be “set up” as a defence, and not as a matter of set-off, against an action for the payment of the value of that subject matter. See Smith, Marcus, The Law of Assignment: The Creation and Transfer of Choses in Action, Oxford, OUP 2007, at 13.89. For equitable set-off see, supra, n. 64. Common law abatement and equitable set-off are compared in Cam-Net Communications vs. Vancouver Telephone Co, 1999, 182 DLR (4th) 436 at para 33 (BCCA) as follows: The law recognizes a distinction between what may be termed abatement and equitable set-off. The former, a product of the common law, applies to cases in which a defendant can show that as a result of the plaintiff’s breach, the goods, services, or work provided by the plaintiff are diminished in value. The latter, a product of equity, refers to cases in which a defendant raises a cross-claim which goes directly to impeach the plaintiff’s demands, i. e., which is so closely connected with the plaintiff’s claim that it would be unjust to allow the plaintiff to enforce payment without taking into account the cross-claim. The latter involves damages other than a diminution of the value of the goods or services provided.

137 See UCC Section 9-109(d)(10). The other exception is “with respect to defenses or claims of an account debtor”, under Section 9-404 which is effectively to the same effect as to the rights of an assignee vis-à-vis an account debtor, except that it does not apply to a party liable on a ‘deposit account’, which under article 9 is neither ‘account’ nor ‘general intangible’ on which an ‘account debtor’, whose rights are governed by Section 9-404, is obligated. See UCC Section 9-102(a)(2), (3) (29) and (42).
account is the customer’s right against the bank, so that the size of the amount claimed by the customer under the right is reduced by the size of the amount claimed under the bank’s recoupment right. No special provision to that effect exists in personal property security legislation in Canada. This is so because the point is covered by OPPSA Section 40(1.1) providing in general for the account debtor’s right to assert against an assignee defenses available to the account debtor against the assignor/creditor. The UCC has such a general provision but nevertheless a special provision is required, because unlike under personal property legislation in Canada, the bank deposit is not an ‘account’; hence, the general provision applicable to the rights of an account debtor does not apply to a bank owing on a bank deposit. However, the priority under UCC Section 9-340(a) of the bank exercising a set-off by combining account over a third-party secured party may not be justified, at least as a universal principle applicable under all circumstances. It may go too far when the security agreement was made with the consent of the bank. More generally, priority of set-off over the third-party secured party’s adverse claim appears to undermine the mutuality required for a set-off. I suppose then that the provision ought not to be read literally. Stated otherwise, the provision ought not to be read as overriding the inherent or built-in limitations to the right of set-off. Indeed, it is recognized that UCC Section 9-340 purports to deal with “rights of set-off and recoupment that a bank may have under other law” and “does not create” such rights; “nor is it intended to override any limitations or restrictions that other law imposes on the exercise of those rights”. Rather, as pointed out, it deals with the priority to the funds on deposit between such rights and those of the secured party. At the same time, suffice it to say then that UCC Section 9-340(a) would have benefited from some refinement.

138 As well as by parallel provisions elsewhere in Canada.
139 See text, supra, at nn. 52-58. Note that in this framework the bank is the account debtor, the secured party is the assignee, and the customer is the assignor/creditor.
140 UCC Section 9-404 (restating the earlier UCC 9-318-1) as pointed out, supra, in text and n. 57.
141 In contrast to Canada, (see text, supra, and n. 21) “Deposit account” is specifically excluded from the definition of “account” in UCC Section 9-102(a)(2).
142 Mutuality is premised on the principle that “the claim and cross-claim must be between the same parties in the same right”, Goode on Legal Problems of Credit and Security, Louise Gullifer (ed), 4th ed., London, Sweet & Maxwell, 2008, at 331, so that “one’s man money shall not be applied to pay another man’s debt”, Jones vs. Mossop, 3 Hare 568, 1844, at 574, 67 ER 506.
143 Official Comment 2 to UCC Section 9-340.
The second rule of UCC Section 9-340 is contained in subsection (b). Thereunder, “a right of recoupment or set-off of the secured party as to a deposit account maintained with the secured party” is not affected by “the application of [UCC article 9] to a security interest in a deposit account”. According to Official Comment 3 to Section 9-340, this means that a bank “may hold both a right of set-off against, and an article 9 security interest in, the same deposit account”. Furthermore, “[b]y holding a security interest in a deposit account, a bank does not impair any rights of set-off it would otherwise enjoy”. Stated otherwise, in the hands of the bank in which the deposit account is maintained, set-off and security interests may overlap; one does not exclude the other, and each is available to the bank at its pleasure.

However, as indicated, these two rules do not apply where the secured party obtained control of the deposit account by becoming “the bank’s customer with respect to the deposit account” under UCC Section 9-104(3). According to Section 9-340(c), against a secured party holding a security interest perfected by control by becoming the bank’s customer under Section 9-104(a)(3), the bank may not exercise a set-off right “based on a claim against the debtor”. However, Comment 2 proceeds to state that consistently “with the priority rule in Section 9-327(4)”, under which a secured party customer under UCC Section 9-104(3), “has priority over a security interest held by the bank with which the deposit account is maintained”, even in this situation, that of a secured-party customer with perfection under Section 9-104(3), the bank may “exercise its recoupment rights effectively”. This Comment merely clarifies the language of UCC Section 9-340(c) which precludes only the availability of set-off, and not recoupment, against a secured party-customer with perfection under Section 9-104(3).

The result is that, contrary to a set-off, a recoupment right available to a bank against its customer may be exercised by the bank even against funds belonging to the customer, securing the customer’s obligation to a secured party, and held in the bank in a deposit account in the name of the secured party. The secured party-account holder will not benefit from Section 9-332(b), and will not defeat the maintaining deposit account bank’s recoupment right based on a claim against the customer (the secured party’s debtor). As “A transferee of funds from a deposit account” of the customer/

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144 See text, supra, that follows n. 138.
145 See text, supra, at nn. 104 and 105.
146 The priority rule under UCC Section 9-327(4) is set out in text, supra, that is at n.113.
147 In fact, both the debtor and secured party are customers and account holders with the bank. In this paragraph for convenience and ease of identification, the debtor is referred to as customer and the secured party as the account holder.
debtor, the secured party-account holder acting without collusion with the customer-debtor may purport to take “the funds free of a security interest in the deposit account…”,\(^ {148}\) and yet not of a recoupment right by the bank where the deposit is maintained.

**IV. Conclusion**

As the law under personal property security legislation in Canada stands now, a taker of cash collateral does not enjoy automatic priority. Rather, to secure priority, the taker has to seek subordination agreements.\(^ {149}\) Otherwise, the taker’s claim to the ‘cash’ deposited in the debtor’s account will be defeated by a competing secured party’s claim to that account covered by an earlier registration.\(^ {150}\) This is so even if the debtor’s account was specifically opened for the deposit of the cash collateral.\(^ {151}\) To a similar end, a deposit of cash collateral to the taker’s own account is a transaction intended to secure the debtor’s obligation to the taker of the cash collateral. As such it is covered by the OPPSA.\(^ {152}\) This means that the taker’s claim to the cash collateral deposited to the taker’s account may be defeated by a security interest covered by earlier registration against the debtor. In either case, where a purchase-money security interest was timely registered, a claim tracing its proceeds will defeat the security interest in the cash collateral.\(^ {153}\)

Regardless, there is uncertainty in connection with the priority scheme among competing claims to a deposit account. A key point of contention is the characterization of the bank’s right to combine accounts.\(^ {154}\) As a matter of agreement, albeit implied by law, between the bank and the customer, the most appropriate treatment may be that of a legal or independent set-off. However, this characterization does not suit the bank in its endeavour to achieve maximum protection with the view of facilitating the objective of the right. This objective is to the mutual benefit of the bank and the customer, in the form of credit extension by the bank to the customer. Such credit is either in the form of fresh new value, or the deferral of collection

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\(^{148}\) See text, supra, that follows n. 119. Emphasis added.

\(^{149}\) As provided by OPPSA Section 38.

\(^{150}\) See text, supra, n. 29.

\(^{151}\) In which case it may nevertheless fall under an after-acquired property clause (permitted under OPPSA Section 12) of the security agreement of the earlier registrant.

\(^{152}\) For the scope of the OPPSA, see in general text, supra, at nn.13-17.

\(^{153}\) See text, supra, nn. 46-49.

\(^{154}\) See text, supra, nn. 65-70.
of an existing debt. As well, in light of the lack of clarity in connection with the bank’s right to combine accounts, third parties cannot find certainty in taking an effective security interest in bank accounts. For the deposit holding bank the taking of a security interest is an available option; yet relying on this option is a blessing in disguise for both the deposit holding bank and potential searchers in the Registrar under personal property security legislation. This is so as long as perfection requires registration which effectively means the inundation of the Registration system with financing statements by banks taking security interests in accounts held with them. Searches aimed at finding competing registrations may be lengthy and costly. Finally, reliance on contractual set-off may not take the deposit holding bank any further as long as the set-off contract may be construed to be a security agreement.

Under UCC article 9, in Caisse populaire Desjardins de l’Est de Drummond v Canada, the bank would have had a security interest in the deposit account perfected by control and would also have been able to effectively exercise its right of set-off over the positive balance in that account. Regardless, a statutory treatment of security interests in bank deposits inspired by UCC article 9 is a good model to go forward in Canada. Particularly attractive is the mode of perfection by ‘control’ and the fundamentals of the resulting priority scheme. The secrecy counter-argument can be met by the fact that secrecy underlies the way bank accounts are handled anyway as well as by the existing precedent of the perfection and priorities in relation to security entitlements deposited in securities accounts.

This is not to say that every detail of the article 9 scheme in relation to deposit account merits a slavish adoption. For sure, I do not think that introducing perfection by control ought to lead to the exclusion of perfection by registration or filing as it is now the situation in the United States. As well, issues to be thought through include priorities in “identifiable or traceable” proceeds deposited to a deposit account, which is original collateral for a secured party. A clearer scheme is required to cover the knowledge by the bank in which the deposit account is held of a security interest and

155 Supra, n. 24.

156 According to OPPSA Sections 19.1(1), 22.1(1), and 1(2), by reference to the Securities Transfers Act, SO 2006, Chapter 8 (“OSTA”), Sections 25 and 26. See also definitions of “security entitlement” and “securities account” (as well as “financial asset”) in OSTA Section 1(1).

157 See text, supra, nn. 98 and 99.

158 For the perfection and priority of a security interest in “identifiable or traceable” proceeds placed in a deposit account, see, supra, nn. 77-78, 97, 112 and 117-118.
the standard of proof required for having the bank’s rights with respect to it “affected”. Such a scheme ought specifically to address restraining orders, interpleaders, and the inquiry obligations of a bank. Also, the effect of a security agreement between the customer and a third-party, to which the bank has not consented, ought to be dealt with more clearly and directly. As well, the availability of recouacement, or its Canadian equivalents, namely, the abatement and equitable set-off, against a secured party in whose name the deposit account is held requires a re-examination. Finally, the range of circumstances in which the bank’s right of set-off prevails over that of a third party-secured party ought to be re-examined.

In the final analysis, it is the perfection by ‘control’ and the priority given to it that ought to guide law reform in Canada. Specific details of the revised UCC scheme ought to be seriously considered and either followed or rejected on an issue-by-issue basis.

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159 UCC Section 9-341. See text, supra, that follows n. 127.
160 See text, supra, n. 132. Cf. the difference between the (higher) standard of knowledge of fraud required by a bank in order not to dishonour a letter of credit and the (lower) standard of proof required by a court for issuing an interlocutory injunction requiring a bank not to honour the letter of credit. BNS vs Angelica Whitewear Ltd., 36 DLR (4th) 161 (SCC), 1987.
161 See text, supra, nn. 127-136.
162 See text, supra, n. 137.
163 See supra, nn. 64 and 137.
164 See text, supra, nn. 148 and 149.
165 See text, supra, nn. 139-144.
166 Official Comment 16 to UCC Section 9-109 points at the ‘control’ requirement, together with the designation of the “deposit account” as a separate category of collateral, as examples to the “several safeguards” contained in article 9 designed “to protect debtors against inadvertently encumbering deposit accounts and to reduce the likelihood that a secured party will realize a windfall from a debtor’s deposit account”.

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