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# Taking and Perfecting Security Interests in Collateral Subject to Specialized Rules: Deposit Accounts, Commercial Tort Claims, Intellectual Property

Steven O. Weise

Neil G. Williams

*Loyola Univeristy Chicago, School of Law, nwillia@luc.edu*

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**Taking and Perfecting Security Interests in  
Collateral Subject to Specialized Rules: Deposit Accounts,  
Commercial Tort Claims, Intellectual Property**

*Steven O. Weise and Neil G. Williams,  
with Allen Richard Kamp as moderator*

ABRAHAM FENG ZHOU: Thank you, Professor Franklin. Thank you, Professor Greenberger. Now we have our second panel, which is the first panel in the afternoon. The subject matter is taking and perfecting security interests in collateral subject to specialized rules.

In this panel, we are honored to have two panel speakers and one moderator. We will have Mr. Steven Weise, who flew from California yesterday to join us, and we have Professor Neil Williams from Loyola University School of Law to join us as a co-panel speaker, and we also have Professor Allen Kamp from the John Marshall Law School as panel moderator. Thank you.

ALLEN KAMP: Isn't the original idea of simplicity? Again, I think the answer to that is "yes," but whether or not this is a good thing or a bad thing I think is debatable. But another thing for the topic today is that the point of the Code was sort of the creation of the unitary—or a big part of Article 9<sup>1</sup>—was the creation of the unitary security interest and that is that you would have one security form that would cover really all sorts of collateral.

Now, they did not quite get there, but they were trying do that. But I just wonder. And then if you read the Code again, which I said I did for the first time after several years because I was going to teach part of it. I was sort of shocked to find out there are all these sort of weird types of collateral, which I had no idea what they were talking about. I still do not really understand most of the stuff. So are we getting away from this idea? Is that a good thing? I mean, do we really need these specific individual rules for these specific types of collateral, and that is something I would like to ask.

Now, once again, one can argue that yes, we do, saying to people, you know, it is not one size fits all. But I think we are all drifting away or purposely going away from the original ideals of the UCC and get-

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1. U.C.C. § 9 (2001).

ting kind of back to a pre-Article 9 system, which I think Grant Gilmore said was sort of the wood, the sticky end wood which Dante encountered before he entered hell and it was just sort of a true mess.

Anyway, I would just like for the esteemed panelists to just discuss a little bit: Do you think we are heading in the right direction or are we going in the wrong direction? Should we go back to the good old Article 9, which is to become more conservative as we get older? If it was good enough for Grandpa, it is good enough for us, right? Thank you.

NEIL WILLIAMS: Thank you very much. You are right. Sticky wood is complex. When I first started teaching the course, it was so much easier to teach. There were a few core ideas and they extended pretty much across types of collateral. I am honored to be on a panel with Mr. Steve Weise, because he can certainly provide us some background perspective on what the drafters were thinking.

What I am going to cover in—what we are covering in this block—are how you go about taking security interests in deposit accounts, commercial tort claims, and intellectual property rights under Article 9<sup>2</sup> as it now exists. And before we can really have a conversation about this, we have to grapple with these complex rules. So what I am going to do in my part of the presentation is basically provide some structure. I am going to give a fact pattern which will guide us through the application of some of these principles; but I will have to admit Steve Weise has even helped me along. There were some things in my fact pattern that I hadn't taken into account. He is going to elucidate. And once we have that framework, Steve is going to come in with his insights and resubmit the answers in the case law.

First of all, in thinking about collateral, what you have to do is situate it in your mind in the scheme of Article 9, and again, it is not as simple as it once was but I am going to briefly just go over the structure of Article 9 collateral using some mnemonics that I find helpful because as I tell my students, if you can keep it in your mind, you are most likely to apply the correct rule, particularly with respect to matters like deposit accounts, commercial tort claims, and intellectual property.

First of all, the structure of Article 9 focuses on certain types of collateral. Some types of collateral are subject to perfection by possession, things that are tangible that you can hold on to. There is a list certainly in § 9-313,<sup>3</sup> and the item listed in § 9-313<sup>4</sup> will be subject to

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2. *Id.*

3. *Id.* § 9-313.

perfection by possession and can also be perfected by filing, except as indicated.

I am a jazz fan and so I tell my students, in thinking about the list of collateral set out in § 9-313,<sup>5</sup> think of something that would be abhorrent to true jazz fans: You are at a concert watching the great Charlie Parker play disco music. And someone shouts out, “Man, good disco, Charlie Parker!” And what are the types of collateral subject to possession under § 9-313?<sup>6</sup> Goods will be goods and, of course, the four subcategories of goods. The disco, you have to remember that the O is silent so man, good disco, the D is for documents, the I is for instrument, the SC is for stock certificates, or more broadly, certificated securities. “Man, good disco, Charlie Parker,” well, the Charlie Parker collateral will be, of course, chattel paper.

Then you have the money, however, it is the only type of possession collateral that cannot be perfected by filing a financing statement. Next, you get to the types of collateral subject to perfection by control, which is a relatively new concept introduced in the 2001 amendments, and I am very happy to have Mr. Weise’s insights on these categories of collateral.

Again, just so you can keep in mind, have a framework. Once again, I have a mnemonic: “DAs in Philadelphia encounter danger establishing criminal procedure, lots of cases.” So which types of collateral are subject to perfection by control under § 9-314?<sup>7</sup> Well, deposit accounts, those are the “DAs.” “In Philadelphia,” investment property, which will, of course, also include certified securities. Electronic documents are the “encountering danger.” “Establishing criminal procedures,” is electronic chattel paper. In “lots of cases” is letter of credit rights. The interesting thing about the order that I have established is that the first and last items of this list, deposit accounts and letter of credit rights, may only be perfected by control. You cannot, and we will be focused on deposit accounts in particular, perfect a security interest in a deposit account by filing a financing statement.

After that, if you have collateral that is not listed in § 9-313<sup>8</sup> as being subject to perfection by possession, and it is not listed in § 9-313<sup>9</sup> to being subject to perfection by control, you have everything else left over. In particular, you will have accounts and commercial tort

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4. *Id.*

5. *Id.*

6. U.C.C. § 9-313.

7. *Id.* § 9-314.

8. *Id.* § 9-313.

9. *Id.*

claims, which I, again, will focus on specifically; general intangibles, and the three types of general intangibles in particular often are the subject of interest, payment intangibles, software (if it is not embedded in goods), and intellectual property rights, which I will also be talking about: copyrights, trademarks, and patents.

I also have a little mnemonic for this one. If you put accounts first, you can say, “Accounts contract flaming generous interest payments in South Indiana Property,” the “Indiana property” being intellectual property rights. So again, just so you can keep it in mind and note if you have collateral that cannot be possessed and cannot be controlled; inferentially that means the only way to perfect a security interest is by filing a financing statement.

Before we go through the fact pattern, I would also want to focus your attention with respect to commercial tort claims on § 9-204,<sup>10</sup> which will provide that an after-acquired property clause cannot attach a security interest to a commercial tort claim. Also in relation to commercial tort claims, a specialized rule that will be applied is the one in § 9-108(e),<sup>11</sup> which says in describing commercial tort claims you cannot do so generically. You have to have a rather specific description of the commercial tort claim.

It is one thing to have these things set out in general. It is another thing to try to apply them. I have a fact pattern for you that will help us navigate through some of these rules in a context. In this fact pattern—I’ll try to keep it interesting—but you have a debtor in a state that honors vegans. And her name is Cara Carrot and she is going to start up a vegan restaurant business.

She actually has come up with a novel idea and that is that you can have a mushroom and barley mixture, which will perfectly simulate the taste and texture of a sirloin steak. It would be my dream to be able to eat vegetables and have them taste like a sirloin steak. So she was issued a patent certificate, which we call Patent Certificate ABCD. This will be our illustration, generically speaking, for intellectual property rights.

She then takes a loan from Filing Statement Finance, and Filing Statement Finance, in accordance with its name, is going to try to perfect a security interest in these various categories of collateral by filing a financing statement. So it files a financing statement in an attempt to perfect a security interest in the deposit account, Account 1234, with Account National Bank. It also files a financing statement in an

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10. *Id.* § 9-204.

11. U.C.C. § 9-108(e) (2001).

attempt to perfect a security interest in all of Cara Carrot's commercial tort claims and it also files a financing statement in an attempt to perfect a security interest in Account 1234.

And we are going to see, interestingly, that there are going to be issues with respect to whether or not this filing properly perfects a security interest in relation to all three of these categories of collateral. So the old Article 9, the simple idea that you can file a financing statement and for the most part perfect a security interest of just about anything certainly is now by the wayside.

Next up is a lender, we will call Control Agreement Capital, and you will see it is given that name for a reason. Control Agreement Capital also attempts to take a security interest in Account 1234. It does so by entering into an agreement involving the debtor, Control Agreement Capital, the secured party, and Account National Bank, the bank at which the account is maintained. And in this control agreement, Account National Bank agrees to follow any instructions from Control Agreement Capital directing the disposition of funds in Account 1234 without further consent from Cara.

This agreement further specified that any such instructions from Control Agreement Capital regarding the disposition of funds in Account 1234 would have to be accompanied by a certification from Control Agreement Capital that Cara was in default. Next up is Account National Bank itself, the bank at which the account is maintained, which also attempts to get a piece of a security interest in Account 1234 and it attempts to take a security interest in Patent Certificate ABCD. Account National Bank, the bank at which the account is maintained, attempts to take possession of Patent Certificate ABCD. So the issue will be: to what extent will that work?

Next up will be Bank's Customer Finance. It too is named to represent the fact that it is going to attempt to elect to take a security interest in Account 1234 by means of becoming the bank's customer in relation to Account 1234. Note, and I had an interesting point by Steve Weise in this type of situation, the agreement that Bank's Customer Finance has with the bank should have a stipulation that if there is a conflict between instructions from the Bank's Customer secured party and the debtor, that the Bank's Customer secured party's instructions should override those of the debtor in order for this arrangement to work as a means of establishing control.

On June 1, a vegan food critic with a website called Collard Green—and I will leave it up to people far beyond me to determine whether this particular tort claim might be meritorious—but he says some things which arguably would be the basis of a slander or a liable

suit by Cara Carrot, and she, in the fact pattern, is careful to make sure that she is bringing the claim in relation to damage to her business interests. As we will see, this will give rise to a commercial tort claim. It turns out the damage done by this report by Collard Green is considerable. Vegan action group VETA pickets her business. She's forced to file for bankruptcy. So in this context we are going to have to determine who is properly perfected and who has priority in relation to these various categories of collateral.

I have several questions and I have written out brief analyses of these questions, which you can read in more detail later on. But for now, I will just give the gist of them. Well, the first thing is whether Account 1234 is a deposit account. It is in one of these special categories of collateral called a deposit account, and before 2001 deposit accounts could not serve as original collateral. But under the structure of new Article 9, deposit accounts can serve as original collateral.

Also in relation to deposit accounts, there is an applicable scope provision. Deposits accounts cannot be used as collateral in a consumer transaction. And here is the brief analysis: Yes, it is a deposit account. The Code basically defines the term of deposit account to be a standard bank account. But not every transaction involving the use of a deposit account is original collateral. It is covered by Article 9. Again, I point out under § 9-109(b)(13),<sup>12</sup> there is an exclusion for consumer transactions.

So if the bank account is a personal bank account, the bank account is being held for personal use and the loan is being used for personal family or household use, then you would have a consumer transaction and Article 9 would exempt that transaction from the scope of the Code. So in this particular fact pattern, we would not have a problem because the bank account is a business bank account and all the loans are for business purposes.

Then we ask: (1) does Filing Statement Finance have a perfected security interest in Account 1234, and (2) whether the answer to this question would change if Account 1234 were represented by a certificate of deposit? And this is where all that structure I went through with you to keep all of these things in mind will come into play. You will remember our little ditty that "DAs in Philadelphia will encounter danger establishing criminal procedure, lots of cases," that the first and last elements of that little ditty, deposit accounts and letter of credit rights, are collateral that are only subject to perfection by control.

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12. U.C.C. § 9-109(b)(1) (2010)

You cannot perfect a security interest in a deposit account by filing a financing statement. This means that Filing Statement Finance does not have a perfected security interest in Account 1234. If Account 1234 were represented by a certificate of deposit, the analysis might change because a certificate of deposit under the structure of the Code is basically recognized as being the bank's promissory note.

I will say, and I am sure Steve Weise will emphasize, as the term promissory note is used in the structure of the Code we mean a negotiable promissory note. So if you had a certificate of deposit which was nonnegotiable, you might reach a different result and, indeed, one of the cases has. Of course, a negotiable promissory note is an instrument, and instruments, as you will recall, is a category of collateral subject to perfection by either possession or filing a financing statement. It is the "I" in "disco."

Next question is: does Control Agreement Company have a perfected security interest in Account 1234, and would it have a perfected security interest if Cara was also required to join in corroborating her status as being in default? And also in relation to control agreements: will a control agreement be allowed to substitute for attachment purposes for § 9-203's<sup>13</sup> general requirement that there be a written, signed security agreement?

Control Agreement Capital has a perfected security interest in Account 1234 because it is in control, but let me emphasize in this regard Steve Weise's point: make sure that the language is such that it is clear that any instructions from Control Agreement Capital, once it has asserted control, will override any contrary instructions from the debtor. But at least I attempted to draft this so it will effectively create a control agreement, which would give Control Agreement Capital priority.

The control agreement in the above fact pattern is authenticated by the traditional method of signing a tangible writing, but Article 9 is now flexible enough to permit—I believe some of this language was just added by the amendments—to permit the authentication of records including electronic and cyber documents in a variety of ways, including logically associating the record with an electronic sound, symbol, or process. Section 9-203(b)(3)(d)<sup>14</sup> provides that if there is an authenticated control agreement, there is no need to have an authenticated security agreement for attachment purposes.

Next up, does Account National Bank have a perfected security interest in Account 1234? And indeed, it does, because ANB is the

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13. U.C.C. § 9-203 (2001).

14. *Id.* § 9-203(b)(3)(d).



bank at which the account is maintained and therefore entitled to control status under § 9-104.<sup>15</sup> Does Bank's Customer Finance have a perfected security interest in 1234? And this is something on which I would like Steve Weise to elaborate—I ask my former students who now work in the real world—What is going on with regard to the use of bank accounts as original collateral? I ask them if any of them ever had a client who elected to become the bank's customer in relation to one of these transactions. They respond, "Professor Williams, this does not happen." But I want to know from you: Does it happen?

STEVEN WEISE: It happens pretty rarely because the bank is afraid it is going to have to pay taxes on the interest in the account so they will rarely do that. They prefer to use the control agreement, which I think is sort of backwards because you are always fighting with the bank where the deposit account is maintained to negotiate the control agreement because they have got a form. They do not want to change it, and life is difficult.

And when they do not cooperate, what we end up doing is threatening to take the account to another bank that will be more cooperative. But very rarely does the bank become the customer—the secured party, rather, becomes a customer.

NEIL WILLIAMS: Okay. But it can happen and now that we have been exposed to your real life experiences, we know it is possible. I am sure the practitioners out there, if you have ever been in a situation where you have a client who wants to become the bank's customer in order to control an account, I would say call Steve Weise.

If it is done properly, Bank's Customer Finance will have a perfected security interest in Account 1234 by virtue of becoming the bank's customer in relation to the account. And let me emphasize, as Steve Weise did to me, that there would need to be a provision in that agreement with the bank which would provide that the Bank's Customer secured party's instructions would override any contrary instructions from the debtor. But when this is done, you would end up with Bank's Customer Finance being properly perfected by virtue of this control agreement.

Then we get to the priority questions, and these are interesting, too, and correct me because I was not quite sure that these rules made sense. But let's try to apply them. Does Control Agreement Capital or Account National Bank have priority in Account 1234? They are

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15. *Id.* § 9-104.

all perfected by control. I would argue § 9-327(3)<sup>16</sup> is giving Account National Bank priority over the control agreement party.

STEVEN WEISE: That is right, because when the secured party is the customer and the account is the secured party's account, then it is not the borrower's account anymore, so that even though the borrower has an interest in the value of the account, the bank, in the control situation, in effect has a security interest in something that is not really the borrower's as a matter of ownership rights anymore. So that is right. When the secured party is the customer, that gives it the best priority of all.

NEIL WILLIAMS: Okay. And that is the way the rule works. Then we have priority battle between Bank's Customer Finance or Account National Bank. In this case, Bank's Customer Finance will beat out Account National Bank under § 9-312(4).<sup>17</sup>

And this is the one I am going to need your help on, because whether Control Agreement Capital or Bank's Customer Finance have priority in Account 1234, I read § 9-372<sup>18</sup>—the residual—as coming into play, and it would give priority to the first party to establish control. And under the fact pattern, as I have it, Control Agreement Capital was first in time. But that would create somewhat of a conundrum because you would have a situation where Bank's Customer Finance would beat out Account National Bank while Account National Bank would beat out the control agreement party, but nonetheless the control agreement party would beat out the Bank's Customer party.

STEVEN WEISE: Remind me how Bank's Customer Finance perfected.

NEIL WILLIAMS: Right. It becomes the customer.

STEVEN WEISE: Yeah. They are going to win because the first to obtain control rule is a subordinate rule to the rule that says a control agreement loses to the secured party who is a customer. So it is—I will talk about this in a few minutes about complexity.

NEIL WILLIAMS: All right. I am looking forward to your discussion of that one.

STEVEN WEISE: I will come back to that.

NEIL WILLIAMS: Yes. Then there is a tort claim against Collard Green, and is it a commercial tort claim as defined in Article 9?

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16. *Id.* § 9-327(3).

17. *Id.* § 9-312(4).

18. U.C.C. § 9-372 (2001).

Yes. A commercial tort claim, if it is a tort claim brought by an organization, like a corporation, would automatically be deemed a commercial tort claim. When the claimant is an individual operating a business, a tort claim is a commercial tort claim if it arises in the course of the claimant's business, and it does not include damages for personal injury or death. In this case, Cara's claim is for damage done to her business interests, but again, I would look forward to it if you, Steve, have any further comments on how commercial tort claims work.

Then the interesting question: remember again, we have Filing Statement Finance attempting to perfect its security interest in this commercial tort claim by filing a financing statement, while commercial tort claims are in that category of collateral that is not listed in § 9-313<sup>19</sup> so it cannot be possessed; it is not listed in § 9-314,<sup>20</sup> so it cannot be controlled, which means the only way to perfect a security interest properly in a commercial tort claim would be by filing a financing statement.

But you have to keep in mind the special attachment provisions in relation to commercial tort claims. And, of course, in order to become perfected, a security interest must first attach.

And there are two problems here: One, § 9-204<sup>21</sup> provides that an after-acquired property clause cannot attach a security interest to a commercial tort claim. The idea with commercial tort claims, and I am sure Steve Weise can give us further background on this, is that it should be a claim that is already in existence, and it should be specifically described, hence the further requirement in § 9-108(e)<sup>22</sup> which says that for attachment purposes in a security agreement a commercial tort claim should be specifically described. So despite filing a financing statement, Filing Statement Finance does not have a perfected security interest in the commercial tort claim in this fact pattern.

Next up, Patent Certificate ABCD, a representative of intellectual property rights, which will be the general intangibles. They are listed in § 9-313<sup>23</sup> or § 9-314,<sup>24</sup> and they are accounts or commercial tort claims, hence they are general intangibles. And the way you would generally perfect a security interest in a general intangible is by filing

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19. *Id.* § 9-313.

20. *Id.* § 9-314.

21. *Id.* § 9-204.

22. *Id.* § 9-108(e).

23. U.C.C. § 9-313 (2001).

24. *Id.* § 9-314.

a financing statement. The issue here, however, is the financing statement was filed in a state Article 9 office, and there are at least some cases which suggest in relation to intellectual property rights under certain circumstances, that in order to properly perfect a security interest, paperwork needs to be filed at the federal level.

Mr. Weise has some very interesting cases in this regard, and I know that you are all anxiously awaiting his presentation. So now, Steve [Weise], I look forward to hearing your comments.

STEVEN WEISE: Thank you. One of Allen's questions first is: Did we make a mess out of Article 9 when we revised it a dozen or so years ago?

I am going to go back even further in time to before the original Article 9 which was completed in the late 50s and early 60s. Before that, the secured transaction system in the United States was a variety of laws, none of which coordinated with each other. So the great beauty of the original Article 9 was what Allen referred to, which was the unified concept of a security interest, which brought together in a single statute—Article 9 of the UCC—all these different laws. There was the Uniform Trust Receipts Act and pledge acts and all sorts of different laws that sort of knew each other existed, but to establish priorities as between rights created under different laws in dealing with proceeds of other collateral, it just did not work very well.

So the brilliant insight of the original Article 9, when I was still pretty young and more worried about playing baseball in the street, was to create this unified system. But when the original Article 9 was put together, some kinds of collateral were kept out. Deposit accounts, except in Hawaii, California, Illinois, and Idaho, were outside of Article 9, and that is because the bank said, "We do not want to be messing with secured parties so just keep deposit accounts out of that Article 9 of yours and we have our setoff rights against them. We do not care about security interests."

So the original Article 9 did not cover deposit accounts and then the original Article 9 did not cover tort claims—and we are talking about commercial tort claims here in part at that time because people thought, "Who would take the security interest in a tort claim? What is the purpose of that? Because that is not a very easy-to-value kind of collateral." So when the revisions came along in the late 1990s, security interests in deposit accounts worked very well in the four or five states that allowed it and the drafting committee said, "Well, let's fold that in all together." There was still some resistance. Some of the banks still did not like the idea, so we did this sort of half a loaf, which is that you can perfect a security interest in a deposit account only by

control, as Neil Williams was just talking about, but not through filing a financing statement.

So the idea was if you really cared about it, then you would get your control agreement or become the customer at the bank where the deposit account was located. You would satisfy those requirements. If you did not really care, and you were just lazy and all you wanted to do was have a financing statement, then you were not going to get perfection in the deposit account. You might note in Canada, our neighbors to the north, you can perfect a security interest by filing the Canadian equivalent of a financing statement to perfect a security interest in a deposit account.

And then further, the consumer interests at the Article 9 drafting committee a dozen years ago did not want to permit security interests in deposit accounts because they were afraid that consumers would grant security interests in their deposit accounts, and it would be too easy and they would end up losing their deposit accounts. So consumer deposit accounts and consumer transactions were also excluded from Article 9, but in our view, bringing deposit accounts into Article 9 was an advance because without deposit accounts in Article 9, there was a common law of security interests in deposit accounts, and if you think it is bad to have a complicated statute dealing with how you get and perfect a security interest in a deposit account, when you've got a bunch of judges making up the rules based on their intuition on how we ought to perfect a security interest in a deposit account, then you are in real trouble.

So we think we straightened out the law a little bit in that area, and then same thing with tort claims: A lot of states provided that you could not assign a tort claim because it was personal to the person who was injured, and that was sort of an old-fashioned English common law rule. And businesses have tort claims, so we thought, "Let's bring tort claims in."

The early drafts of the 2001 revisions to Article 9 covered tort claims, and then my telephone rang one day and it was a fellow who was the chair of the American Bar Association's tort law section, and he said, "You cannot bring tort claims into Article 9 because you will have all these personal injury claims, and in the courtroom will be sitting at the plaintiff's table the plaintiff's tort lawyer and sitting right next to him or her will be the secured lender's lawyer whispering in the ear of the tort lawyer messing up how we handle the plaintiff's tort claim."

So that is just not good. You cannot do that. So the compromise was to exclude personal injury claims from Article 9 but to include

commercial tort claims on the theory that we Article 9 lawyers would not mess up things too much as we were anticipated to do with personal injury claims. So we reached that sort of funny compromise and then had those other rules that Neil Williams referred to where you have to describe the claim with some specificity. You cannot say “all commercial tort claims,” and you cannot have an after-acquired commercial tort claim.

And it is hard to describe what an after-acquired claim is when it has not happened yet, so it is pretty impossible to get next week’s commercial tort claim, which is one of the fact patterns here. But by bringing commercial tort claims in also we thought we were sort of making Article 9 more unified, so to speak, in covering more claims, even though we had some funny rules.

With regard to all these complicated rules on priorities in deposit accounts—Is there a control agreement? Is the secured party the customer? Is the secured party the bank where the deposit account is located?—This goes back to what Steve Harris talked about this morning, which is that we had all these people in the room and the banks said, “Well, if you are going to allow security interest in deposit accounts, we want to win if it is at our bank.” And so we wrote a rule that basically says the bank wins. Pretty simple rule, and that was part of the cost of getting that kind provision in there. So there was not necessarily a huge amount of intellectual analysis here as much as dealing with the realities of how to sort of get this by people and get this through people.

So the whole process was pretty interesting, and as we revisited some of this stuff recently with the recent revisions to Article 9 and looked at how people were doing this in the real world in the ten years or so since the earlier revisions to Article 9, we noticed that a lot of this was done through agents. You read in the newspapers about management companies and agency relationships all the time. In the drafting committee the discussion of agency law consisted of about one session. But for students, it’s the first session of your business organizations class maybe, and that is about all you know about agency law.

And it turns out that agency law is just really important in this world. People operate through agents, and if you read Article 1 of the UCC you see in § 1-103,<sup>25</sup> in that article, that the UCC says it follows—except to the extent clearly displaced by the UCC—it follows the law of agency. So one of the changes we made in the comments in

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25. U.C.C. § 1-103 (2001).

the most recent revisions was to acknowledge or confirm what we always thought was true, but we made it clear, that one can possess collateral, one can have control of a deposit account, through an agent if you have properly set up the agency relationships, and we added several references in the comments to the use of agents in all of these areas.

So if you find yourself practicing in this area, one thing you discover you need is a copy of a Restatement of Agency, along with other Restatements like Contracts. And you probably spent a lot of time with the Restatement of Contracts in your contracts class. You might when you start practicing someday—you can get it on the Westlaw or Lexis—keep handy this notion of the law of agency because it turns out to be really, really helpful and really, really useful in a lot of these areas.

And by way of example, I am on something called the Permanent Editorial Board for the Uniform Commercial Code, which is sort of the board of directors of the Uniform Commercial Code, and we decide when there should be amendments, and we issue interpretations and stuff like that. And we just issued a paper on mortgage notes, residential loans that are secured by mortgages. And there has been a lot in the papers about how these are lost through robo-signing and all that, and we addressed a couple of UCC issues, many of which depend on possession of the note. Lots of rules and rights depend on possession of the note.

And it was always the rule, as clear as it could have been, that possession could be through an agent, and one of the things we emphasize in this report we just issued just a few weeks ago is that the possession through an agent works perfectly fine if you have created an agency relationship and if you have gone through the requisite steps to create agency. So agency law is one of those other bodies of law that you do have to deal with in connection with the UCC, and that is a little bit of the theme here in this panel because we have to know about other laws.

JASON KILBORN: Can I interject a question?

STEVEN WEISE: Sure.

JASON KILBORN: I actually teach several weeks of agency for the reasons you suggested it, and you said a couple of times if you go through the steps to set up the agency, well, the Restatement Second and Third say agency is just a relationship. There is no formality at all. There is no such thing as a step as far as I can tell. What do you mean when you say as long as the agency has been set up?

STEVEN WEISE: Well, I think, at least the Third Restatement, which is the one I looked at most recently, says that agency depends on a level of control in the relationship between the principal and the agent. So I think to prove to a court that the control exists, I think it is useful to have an agreement that says, "For purposes of this transaction you are holding for me" and I quote, "control"—I mean, I used the word control—"but I control your acts with respect to the kinds of collateral that are physically in your possession." So that is the notion, I think to—

JASON KILBORN: That comment is extremely useful because I make a point of noting that control of a certificate of security by an agent has to be by authenticated record signed by, I think, that agent. And that rule seems to be kind of an outlier, but you just suggested I think something quite useful which is useful even not in that context: It is quite useful to have an actual written agreement with the agent saying, "This is the deal, so that if we ever have to prove what's going on later, we can do that."

STEVEN WEISE: That is right. There was a case recently, not *per se* on agency, but one of the rules for financing statements is that you have to put the name of the secured party on the financing statement and then one of the sub-rules is that you can put a representative—it does not say agent; it says a representative—of the security party's name on the financing statement. So that is fine.

So there was a case where there were three secured parties jointly making a loan and all three of their names were on the financing statement. And then the financing statement lapsed after five years, which is what they do, and only one of the secured parties was awake so it filed a new financing statement. The other two were asleep and did not do that. And the borrower went bankrupt and the trustee in bankruptcy said, "Well, I will take that portion of the collateral that the two who were asleep had a security interest in, and I acknowledge the one who had re-filed is perfected."

So the two that had not filed said, "But the one that did file was our representative," and the judge said, "show me the proof. Show me a piece of paper. Show me an e-mail. Show me anything that shows that it was your representative at the time the clean-up financing statement was filed by the one bank that was awake." So the notion is that it may be that control existed, but you have got to prove it to somebody's satisfaction at some point.

So keep teaching that agency stuff. I throw this stuff out with clients and in programs and people have these vague, distant memories of the law of agency, and it turns out to be very valuable. In this PEB



report I just mentioned, in several places it refers to the law of agency, but it does not say what you have to do to establish the agency relationship.

So a little bit more on deposit accounts. We mentioned the question is: What the heck is a deposit account? The insight I had a long time ago when I went to a continuing education program as a new lawyer is that a deposit account is debt of the bank to its customer. When you put money in there, they do not take your twenty-dollar bill and put it in a little stack and say, "This is Steve's twenty-dollar bill." They put a little note on their books that says, "We owe Steve twenty dollars." The twenty-dollar bill disappears, the one I deposited.

When I was in second or third grade, we took a field trip to a bank, and we each had five dollars from our parents, and we created a bank account. And they gave us a little bankbook. I do not think bankbooks exist anymore. And it is stamped in there "five dollar deposit." And I can remember the guy from the bank saying, "Do not lose the bankbook because then you will lose your five dollars," which was wrong, but that is what he told us, as if, you know, the little book was the money somehow.

Well, the bank just owes me money. Now, the certificate of deposit is like a note that the bank issues and says, "I owe the holder of this money," and if there is a certificate of deposit that is represented by a piece of paper so that it can be an instrument, then it is no longer a deposit account. It is an instrument.

And if you are in this area, you have got to be careful because a lot of certificates of deposit these days are not represented by a certificate even though they are called a certificate of deposit. There is just an entry on the books of the bank that Neil's got a certificate of deposit with us. And when they are that kind of certificate of deposit, they are not an instrument because the definition of promissory note or instrument is that it is going to be on paper. It is old-fashioned but that is just the way it is.

So a certificate of deposit that is not on paper is a deposit account, whether you like it or not, and the only way to perfect the security interest is by the control agreement. If it is a certificate of deposit, then it is an instrument. Then it is an instrument, and you can possess it or you can file financing statement to perfect that security interest.

So the rules here are really complicated. It is part of the cost of bringing deposit accounts into Article 9. You can do it through an agency relationship. Often you will have the secured parties, maybe ten secured parties, who jointly make the loan. They will designate one of them to be their agent. That person may have the deposit ac-

count at the bank of the agent to perfect through the mechanism that says if the secured party is the bank where the deposit account exists, it creates control. All that works just fine. Again, it's back to agency law and operating through an agent to make life a little bit more efficient.

The other area where there has been a lot of debate and litigation lately is setoff, because setoff is when I owe you money and you owe me money. If I owe you one hundred dollars and you owe me eighty dollars, instead of my paying you one hundred and you paying me eighty, I should just pay you the leftover, which is the twenty, and sort of net everything out.

Banks love setoff against deposit accounts because the deposit account is the bank owing money to the customer. If the customer borrowed money from the bank, the customer owes money to the bank. Instead of exchanging money you net out everything and whoever has the net balance gets a little bit of money but not the full amount of money.

There have been a couple of cases lately where there has been a dispute over whether when the bank takes a security interest in the deposit account at the bank it somehow waived its right of setoff, and then if the bank makes a mistake in perfecting that security interest, the debtor says, "I got you because you waived your setoff, and you do not have a perfected security interest so you have got to pay me, and you do not get the money when I am in bankruptcy." So a lot of people have been adding clauses to their agreements to say, "When we take a security interest, we do not waive our setoff rights."

But setoff is not an Article 9 concept and like agency, it is another body of law where you have to deal not only with the Uniform Commercial Code but with related bodies of law, and we will come to some more of that in just a second.

Now, the commercial tort claims. As we mentioned, you can take a security interest in a commercial tort claim under the 2001 revisions to Article 9 but not under the prior version of Article 9. But the interesting question here, and this again goes to other law, is: What is a tort claim? It is easy if you run over somebody or run into something; everybody knows from first-year torts, that is a tort claim. But the question is: What if you have a breach of fiduciary duty claim against somebody? What if you have an infringement claim involving intellectual property? What if you have a disclosure of trade secrets claim?

What are those? If they are commercial tort claims as opposed to general intangibles—other kinds of disputes—then the rules that Neil

Williams described, you would have to be more specific in your description. You cannot get an after-acquired commercial tort claim as collateral.

And there are about a dozen cases in the last twenty years that talk about that question, and they say the kind of claims that I described, the breach of fiduciary duty, infringement of intellectual property, disclosure of trade secrets, are “akin to,”—that’s the phrase—a tort, and therefore we are going to treat them as commercial tort claims and therefore they are going to be subject to the limitations in Article 9 that apply to commercial tort claims. So in creating this special set of rules for commercial tort claims, we have in effect made a little bit of trouble for security interests in these other kinds of claims, and this is all part of a deal to bring tort claims into Article 9.

And there are companies out there now, and I represent some of them, that make a business out of financing tort claims. Somebody suing somebody on a commercial tort, could be interference with contract, for example—you studied all that in your tort classes, the lender comes in and does an analysis of the claim and puts a value on the claim and then makes a loan and then may finance the owner of the claim, in a sense, as they proceed with the litigation.

So this has become an awfully important area of the law that I do not think we all had anticipated, and the place where it sneaks up on you, if you are a tort lawyer and you are bringing a commercial tort: You may take what people think of as an attorney’s lien on the claim on a contingent fee claim—a contingent recovery, rather, that the client might have.

What a lot of plaintiff’s tort lawyers do not realize because they never studied Article 9 is that their claim may well be an Article 9 security interest, and in order to get and perfect a security interest in their client’s very own claim against some defendant, they need to jump through the Article 9 hoops that Neil Williams was referring to. And there were some cases last year where lawyers who are plaintiff’s tort lawyers who just are not familiar with this area of law did not do that and lost out in their recovery rights against their very own clients. And the client got a big recovery but did not pay them, and other creditors grabbed the money.

So as we, as me, and people like me as Article 9 lawyers, have to know other law, lawyers in the other areas have to know this kind of subject. When the new Article 9 came in, I gave a lecture a dozen years ago on this point, one of the lawyers in the audience raised her hand and said, “Wait a minute. Wait a minute. My husband does that plaintiff’s tort stuff. You mean I’ve got to teach him Article 9?” I

said, “Yeah. It is another great thing to talk about over breakfast. What could be more interesting?” And I assume they went and did that sort of stuff.

So again, none of these areas of the law exist in isolation, and part of what I am talking about here today is understanding the relationships between the different bodies of law. There are two recent cases that have dealt with security interests in securities accounts, which will be an account of a securities broker, which is very similar to the rules for deposit accounts. And these two cases have made some mischief in this area.

One of them is a case called *Monticello*.<sup>26</sup> In the *Monticello* case the court held—let me go back: Section 9-108<sup>27</sup> says any reasonable description of collateral will work and then one of the subsections towards the end says, “Well, if your security interest is a securities account which is not covered by Article 8,”—because almost nobody has ever read Article 8—“if you do not do a very good job of describing it, you do not have to be too careful, any of the following words will work.”

What the *Monticello* court said was not that “any” of the following words will work, but that “only” the following words will work, so if you do not use the magic words—what the court thought were the magic words—you do not even get a security interest in a securities account. So one would worry that some other court would compound the mistake and require some magic language for deposit accounts. So we hope not.

And then in a case called *Smith*,<sup>28</sup> there was a control agreement case for a securities account and it requires that the securities broker, what is called securities intermediary in Article 8, agreed, key word was “agreed,” that it would follow the instructions of the secured party, which is the same concept you have for a control agreement for a deposit account. And in that case the securities intermediary had said that it would consider agreeing but they never got to agree, and the court said that is not an agreement. And I think the court was certainly right.

How much of an agreement do you need? Consideration and writings and all that? That is a separate question. But you do need to be pretty careful that you need some sort of agreement as opposed to

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26. *Monticello Banking Co. v. Flener*, No. 1:10-CV-121-R, 2010 U.S. Dist. LEXIS 132300 (W.D. Ky. Dec. 13, 2010).

27. U.C.C. § 9-108 (2001).

28. *Smith v. Powder Mountain, LLC*, Nos. 08-80820, 08-81185, 2011 WL 2457906, (S.D. Fla. June 16, 2011).

what had happened there, that the intermediary said it would consider agreeing but never agreed. It is promising. It is talking about agreeing but never actually getting there.

So even though these rules exist, we thought: Did we do a good job of drafting or not? We thought the rules were pretty clear. Litigators will say anything in litigation to try and upend the security agreement. The counsel for the trustee in bankruptcy is looking for any angle or any hole in the agreement, so you do just need to be terrifically careful.

Finally, intellectual property, involves one of the great provisions of Article 9 in § 9-109.<sup>29</sup> This goes to the lunch discussion about preemption of federal law over state law. There is a subsection in § 9-109<sup>30</sup> that says Article 9 is preempted to the extent federal law preempts it.

Now, you did not need to say in a state law that it is preempted by federal law because federal law would say, "If we preempt you, you do not have any choice in the matter." And we debated. We knew we were saying something stupid when we wrote that, but we did it consciously on the theory that like a lot of lawyers have not read Article 8 or a lot of tort lawyers have not read the UCC, a lot of secured transactions lawyers may forget that there is a federal law sitting out there that might preempt or affect Article 9.

So to the extent that, those magic legal words, to the extent federal law preempts, then federal law preempts. Before I get to intellectual property, the classic examples are security interests in airplanes. And until recently one perfected a security interest in an airplane by making a filing with the Federal Aviation Administration in Oklahoma. Now, it was in Oklahoma because an important senator from Oklahoma was in charge of the committee that adopted that law fifty or sixty years ago, Senator Kerr, so the place to file was in Oklahoma, and it created jobs in Oklahoma, and it got him reelected ten times or whatever it might have been. So you perfected by filing with the FAA in Oklahoma but all the other article rules, Article 9 rules, creation of the security interests, priority of the security interests, foreclosure of the security interest, applied. The only preemption was to the extent of the preemption, which was the rule that you file in Oklahoma to perfect a security interest in an airplane.

Now it has gotten more complicated in the last few years through a convention sponsored by the United Nations. There is something called the Capetown Convention, and the Capetown Convention tells

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29. U.C.C. § 9-109 (2001).

30. *Id.*

you how you perfect security interest in airplanes in any country that is a party to the Capetown Convention—and there are fifty or sixty countries now—and to do that you file in Ireland. You do it electronically. You do not get to go to Ireland to actually file. There is an international filing office in Ireland. But to do it in United States, you have to first file in Oklahoma and then file in Ireland. So good people in Oklahoma, where my father grew up, still get their jobs in Oklahoma. Then you file in Ireland. But again, a treaty, of course, is part of federal law in effect, so it preempts Article 9, so to perfect in the airplane, you do that; all the rest of Article 9 still applies.

So we had this patent on the fake steak, or maybe not-so-fake steak if you believe the critic in the hypothetical situation, and all the old federal intellectual property laws, of course, were written many years ago before Article 9 existed or it was even a gleam in the eyes of Grant Gilmore or Karl Llewellyn or any of those people. So they are not written with all these rules that we are talking about in mind.

And then the individual federal intellectual property laws, trademark, copyright, and patent, each are different from the other, so you have to look at each of those separately. And the first problem is that if you are talking about the owner of the intellectual property, not a licensee but the actual owner of the intellectual property, then you have got to see is there a federal perfection rule.

And it turns out what the cases say that if you have a registered copyright, you have to file in the federal copyright office. But if you have a registered patent or a registered trademark, filing in the federal registration offices for Article 9 purposes does you no good and you have to file a UCC financing statement. And there are plenty of cases out there where people have filed in the wrong place on these sorts of things.

It is doubly complicated because if you have an unregistered copyright, you file in the UCC office, but the minute it is registered, you have to file in the federal copyright office. So where I live in Los Angeles, if you are making a movie, you are constantly doing filings on the copyright of the movie itself and the daily rushes and all that, and until the copyrighted information is registered, you are filing in the UCC office. Once it is registered, you are filing in the copyright office.

And it is a little harder for copyright because in the UCC you can say, “I hereby cover all of your intellectual property to the extent the UCC applied.” For copyrights, you have to identify by copyright number the copyrights that are subject to the filing in the copyright office, so it is much more of a pain and difficult to deal with.

For patents, as I mentioned, or for trademarks you filed under the UCC system, there is an issue that is unresolved by the cases. For a patent, even though you file in the UCC system to protect the secured party in the event of the borrower's bankruptcy, in order to protect the secured party against a buyer from the borrower, you may have to file in the patent office. So people, trying to be careful, will end up filing in both places just to try to protect themselves.

So we've got all these rules in these sort of unusual kinds of collateral. We have some complicated priority rules that apply. These are just a byproduct, particularly in the deposit account area, of bringing that particular kind of collateral into the UCC. The old Article 9 rules for deposit accounts were pretty simple and actually they seemed to work, but when everybody started focusing on it, life got more complicated.

So, Allen, I would say we actually improved the unity of the security interests by bringing them in and getting rid of common law rules, but in bringing them in, we did make life a little complicated and some of these priority rules for deposit accounts and the similar rules, which we are not talking about today, for securities accounts, which are very similar to deposit accounts for these purposes, are also very complicated. And that is just sort of life and that is what keeps me going.

So anyway that is about it. I will be happy to take questions.

JASON KILBORN: You have several Ninth Circuit cases cited under the intellectual property header here that simply say patent licenses are not property for bankruptcy purposes. I wonder what the implication for secured financing was with those cases.

STEVEN WEISE: So have I, and I forgot to mention those. In a license situation, Neil Williams owns the patent, and he licenses me the right to use the patent to make whatever I am going to make that is patented under this process. And I entered into that patent license with Neil ten years ago. It is a twenty year license. I got a really good deal because Neil was a startup company at that point and he was hungry for cash. So we entered into a very low royalty license agreement for me.

Now I have run into some hard times. I am going to bankruptcy, but my license agreement is an asset because I am paying a really, really low royalty to Neil's extremely popular product now, and if we renegotiated that license agreement today, I would be paying a much higher royalty, and Neil would love to get that license agreement back. So I go into bankruptcy, and my plan is to sell my licensee rights through the bankruptcy, get a lot of money and pay my deserving creditors absolutely everything I owe them.

But Neil shows up in my bankruptcy court and says, “Under federal law of intellectual property, it is not an Article 9 issue.” Under federal law—and if you take an IP class, you will hear this—under federal law, a licensee does not have any property. What a licensee has is a right not to be sued by the owner of the intellectual property for the use of whatever rights the licensee has under the license agreement.

And these federal intellectual property cases say that because it is not property under intellectual property law, when the licensee goes into bankruptcy, you look at the bankruptcy code, and the bankruptcy code says that the bankruptcy estate consists of all the property rights of the bankrupt person. And then there is a famous U.S. Supreme Court case called *Butner*<sup>31</sup> which says that in analyzing what property is for purposes of the composition of the bankruptcy estate, you look to other law and see what other laws say is property. And then these Ninth Circuit cases say that we will look to other law. We will look to intellectual property law. For the licensee’s rights, it is not property. Therefore, it is not part of the bankruptcy estate. Neil gets his license back. He is really happy. I am in bankruptcy, and my creditors are very unhappy because I lost a valuable asset.

So then you go to Article 9, and Article 9 says you can create a security interest in personal property, and then § 9-401 says you look to other law to figure out what those property rights are. And so the risk is that some court says that a security interest in a licensee’s rights of intellectual property may not be property for purposes of creating a security interest under Article 9.

I do not know if there is any case that addresses that question. I would hope it would say that is sort of ridiculous for Article 9 purposes and rights are whatever the rights are. And I have got an outline of an article I am going to write about this someday when I have some time. But that is the risk, because the Ninth Circuit cases in copyrights and patents, both exclusive and nonexclusive rights, have all said that the licensee has no property rights for bankruptcy purposes. So whether that applies to Article 9, I do not know, but it is a risk. Other questions?

NEIL WILLIAMS: Steve, in that regard, what about the definition of general intangibles you explicitly include things in action? Wouldn’t that fit into that category?

STEVEN WEISE: It would definitely fit in the definition of general intangibles. The problem would be preemption. If federal law says it is not property, federal law does not care what Article 9 tries to do in

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31. *Butner v. United States*, 440 U.S. 48 (1979).



the event of federal law. So that is the problem. It is a preemption issue. And we have heard a lot about preemption at lunch, and who knows what a court would do.

Others? Okay.

Thank you very much.