

# SECURITY INTERESTS IN DEPOSIT ACCOUNTS AND THE BANKING INDUSTRY'S USE OF SETOFF

## I. INTRODUCTION

On January 1, 2002, revised Article 9 of the Uniform Commercial Code became law in Alabama, codified in the Code of Alabama as sections 7-9A-101 through -709. Revised Article 9, approved by the drafting committee in 1998, implemented many changes to the law of secured transactions, including the virtual elimination of local filing in favor of a centralized state filing system,<sup>1</sup> the restructuring of the criteria for determining in what jurisdiction a financing statement must be filed,<sup>2</sup> and when a subsequent filing in a new jurisdiction is warranted.<sup>3</sup> The focus of this Comment, however, is a party's ability to create a security interest in a deposit account as established by the 1998 text of Article 9. Under the 1972 text of Article 9 as amended in 1997 and codified in the Code of Alabama at sections 7-9-101 through -507, deposit accounts were specifically excluded from the provisions of Article 9 except to the extent the deposit accounts contained identifiable proceeds.<sup>4</sup> Conversely, the 1998 text explicitly brings deposit accounts within its scope and outlines what procedures are necessary for perfection in a deposit account.<sup>5</sup> This Comment compares the possibilities of security interests in deposit accounts under both versions of Article 9 and discusses what effect these new rules may have on the use of setoff by banks in bankruptcy proceedings.

## II. DEPOSIT ACCOUNTS UNDER THE ARTICLES

The core difference between the 1972 text and the 1998 text with regard to deposit accounts is simple. The 1972 text does not allow for a deposit account to serve as original collateral, while the 1998 text does so explicitly. Consequently, the 1998 text must address the issue of perfection in deposit accounts, as well as priority in the accounts. While this basic distinction is

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1. ALA. CODE § 7-9A-501(b) (Supp. 2001) (establishing the office of the Secretary of State as the appropriate office for filing financing statements).

2. *Id.* § 7-9A-301(1) (establishing the debtor's location, not the location of the collateral, as the appropriate jurisdiction for filing a financing statement).

3. *Id.* § 7-9A-316(a)(2) (stating that a financing statement must be re-filed in a new jurisdiction within four months after the debtor's location has changed to the new jurisdiction).

4. ALA. CODE § 7-9-104(l) (1997), *repealed* by 2001 Ala. Acts 481.

5. ALA. CODE § 7-9A-104 (Supp. 2001).

easy to comprehend, properly applying the revised version of Article 9 is a matter of knowing which statutes to read.

### *A. Defining Deposit Accounts*

#### *1. The 1972 Text.*

Before comparing the treatment of deposit accounts under the two versions of Article 9, it is necessary to understand how each Article defines "deposit account." Both versions of Article 9 have statutory provisions defining the terms used within the Article.<sup>6</sup> Under the 1972 version, the term "deposit account" means "a demand, time, savings, passbook or like account maintained with a bank, savings and loan association, credit union or like organization, other than an account evidenced by a certificate of deposit."<sup>7</sup> Under this definition, a deposit account is essentially any account maintained with an organization that accepts money (or deposits) from an entity with an understanding that such deposits will be returned upon demand by the depositor. In a deposit account, the deposit is guaranteed and not intended to fluctuate. Therefore, a stock brokerage or similar investment account is excluded from this definition.

#### *2. The 1998 Text*

Revised Article 9 has a similar, though not identical, definition of "deposit account." The 1998 text states that the term "deposit account" means "a demand, time, savings, passbook, or similar account maintained with a bank. The term does not include investment property or accounts evidenced by an instrument."<sup>8</sup> Incorporated in the definition of deposit account under the 1998 text is the definition of the term "bank."<sup>9</sup> "Bank," as defined under this the 1998 text of Article 9, is an "organization that is engaged in the business of banking. The term includes savings banks, savings and loan associations, credit unions, and trust companies."<sup>10</sup> Under the 1998 text, the term "bank" mirrors the last portion of the definition of "deposit account" as it existed under the 1972 text, except for the addition of "trust companies."<sup>11</sup> Therefore, when combined, the definitions of "deposit account" and "bank" in the 1998 text provide the full working definition of the term "deposit account." A deposit account is "a demand, time, savings, passbook, or similar account maintained"<sup>12</sup> in an "organization that is en-

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6. ALA. CODE § 7-9-105(1)(e) (1997), *repealed by* 2001 Ala. Acts 481; ALA. CODE § 7-9A-102(a)(29) (Supp. 2001).

7. ALA. CODE § 7-9-105(1)(e) (1997), *repealed by* 2001 Ala. Acts 481.

8. ALA. CODE § 7-9A-102(a)(29) (Supp. 2001).

9. *Id.* § 7-9A-102(a)(8).

10. *Id.*

11. *Id.*

12. *Id.* § 7-9A-102(a)(29).

gaged in the business of banking [including] savings banks, savings and loan associations, credit unions, and trust companies.”<sup>13</sup>

The definitions of “deposit account” in the two versions of Article 9 are different, however, in their last sentences. Under the 1998 text, a deposit account is not “investment property or accounts evidenced by an instrument.”<sup>14</sup> Conversely, the 1972 text states that “an account evidenced by a certificate of deposit” is not a deposit account.<sup>15</sup> First, because the 1998 text states that investment property is not a deposit account, then the definition excludes money markets, mutual funds, 401(k)s, or any other type of account where money is deposited and the funds are invested rather than held for later return. Second, the 1998 text allows some certificates of deposit to be deposit accounts that the 1972 text did not. The official comment to the 1998 text explains when a certificate of deposit is a deposit account. The comment states:

Under the [new] definition, an uncertificated certificate of deposit would be a deposit account (assuming there is no writing evidencing the bank’s obligation to pay) whereas a nonnegotiable certificate of deposit would be a deposit account only if it is not an “instrument” as defined in this section (a question that turns on whether the nonnegotiable certificate of deposit is “of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment.”)<sup>16</sup>

The Code makes it clear that in order to understand the term “deposit account” and when a certificate of deposit is a deposit account, one must understand the definition of the term “instrument.”<sup>17</sup> Simply, “instrument” means a “writing which evidences a right to payment of money and is not itself a security agreement or lease and is of a type which is in ordinary course of business transferred by delivery with any necessary indorsement or assignment.”<sup>18</sup> After looking at the comment and the definition of an instrument, the simple meaning of the last sentence of the definition is this: If a party has only an instrument (e.g., cashier’s check, certificate of title) to prove the existence of an account, then the account is not a deposit account.

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13. ALA. CODE § 7-9A-102(a)(8) (Supp. 2001).

14. *Id.* § 7-9A-102(a)(29).

15. ALA. CODE § 7-9-105(1)(e) (1997), *repealed by* 2001 Ala. Acts 481.

16. ALA. CODE § 7-9A-102 cmt. 12 (Supp. 2001).

17. Revised Article 9 states that the term “instrument” means:

[A] negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment. The term does not include (i) investment property, (ii) letters of credit, or (iii) writings that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card.

*Id.* § 7-9A-102(a)(47).

18. 68A AM. JUR. 2D *Secured Transactions* § 55 (1993).

In sum, a deposit account under the 1998 text is: (1) an account held at a bank; (2) where the deposits are guaranteed; and (3) is evidenced by something other than an instrument.

## *B. Security Interests in Deposit Accounts*

### *1. The 1972 Text*

Under the 1972 text, one could not use a deposit account to create an original security interest.<sup>19</sup> Section 7-9-104(l) of the Code of Alabama, which has been repealed by the enactment of the 1998 text, states: "This article does not apply: [t]o a transfer of an interest in any deposit account, except as provided with respect to proceeds and priorities in proceeds."<sup>20</sup> The 1972 text did not allow a business to use its operating account as collateral on a piece of equipment to secure a loan. This did not mean that the holder of a security interest could not reach the funds in a deposit account; it only meant that the deposit account itself could not be a security interest.

As mentioned, a secured creditor can foreclose on monies located in a deposit account even though the creditor does not have a security interest in the account itself. This is possible because of proceeds. While this Comment is not about security interests in proceeds, it is necessary to briefly understand the nature of such interests. Under the 1972 text, "proceeds" were defined as "whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds."<sup>21</sup> When a debtor sells a piece of collateral used to secure a loan, the money received in exchange for that sale is considered proceeds. Under both versions of Article 9, a secured creditor is automatically perfected (for a statutorily set period of time) in the proceeds from the sale of the collateral.<sup>22</sup>

The 1972 text provides that where proceeds are deposited in a deposit account, the secured party has a right to those funds.<sup>23</sup> The right to the proceeds deposited in an account was limited to only those proceeds that were identifiable.<sup>24</sup> However, the 1972 text does not discuss how to identify the proceeds when commingled in a deposit account. Courts, however, have adopted the "intermediate balance" test.<sup>25</sup> The test "provides a presumption that proceeds of the sale of collateral remain in the account as long as the account balance equals or exceeds the amount of the proceeds."<sup>26</sup> Courts identify the proceeds "based on the assumption that the debtor spends his

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19. ALA. CODE § 7-9-104(l) (1997), *repealed by* 2001 Ala. Acts 481.

20. *Id.* (citation omitted).

21. *Id.* § 7-9-306(1).

22. ALA. CODE § 7-9A-315 (Supp. 2001); ALA. CODE § 7-9-306(2) (1997), *repealed by* 2001 Ala. Acts 481.

23. ALA. CODE § 7-9-306(2) (1997), *repealed by* 2001 Ala. Acts 481.

24. *Id.*

25. *Ex parte Alabama Mobile Homes, Inc.*, 468 So. 2d 156, 160 (Ala. 1985).

26. *Alabama Mobile Homes*, 468 So. 2d at 160.

own money out of the account before he spends the funds encumbered by the security interest.”<sup>27</sup> If the amount of funds in the account “drops below the amount of the proceeds, the security interest in the funds on deposit abates accordingly.”<sup>28</sup> Finally, the “lower balance is not increased if funds are later deposited into the account.”<sup>29</sup> Stated more clearly:

[A] creditor is entitled to the full amount of the proceeds if the account remains at all times equal to or greater than that amount but if the amount on deposit is at any time reduced below the amount of the deposited proceeds, the creditor cannot recover in excess of the lowest balance in the account, even though deposits were thereafter made that increased the amount of the debtor’s account.<sup>30</sup>

Essentially, the “intermediate balance” test relies on two assumptions. First, that the debtor spends the unencumbered money first; second, that the encumbered funds cannot be increased by later deposits.<sup>31</sup>

This is easily illustrated with an example. If the debtor has an account with a \$100 balance and then deposits \$50 in proceeds to the account, the new balance is \$150 and the secured party has a security interest in \$50 of the account’s total balance. If the debtor spends \$100 of the money lowering the balance to \$50, the secured party is still perfected in that \$50. This is because of the first assumption—the debtor spends proceeds money last. If, however, the debtor spends another \$20, thus lowering the account balance to \$30, the secured party is only perfected in the \$30. This is because one cannot be perfected in funds that are not available. Now, if the debtor deposits \$500 of nonproceeds money, bringing the balance to \$530, the secured creditor is still only perfected in \$30 because of the second assumption—subsequent nonproceeds deposits do not replenish the value of the original proceeds.

According to the 1972 text, the only way for a secured creditor to foreclose on a deposit account was for the creditor to demonstrate that there were proceeds in the account from the sale of his collateral.<sup>32</sup> If the creditor could not demonstrate the necessary link between the funds in the account and the proceeds from the disposition of the collateral, he could not foreclose on the account. The problems associated with the proof of identifiable proceeds are at least partially remedied by the 1998 text. While the foreclosure of proceeds in a deposit account still requires identification, now a creditor can create a security interest in the deposit account, thus eliminating the necessity of identifying the funds in the account.

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27. *Id.*

28. *Id.*

29. *Id.*

30. 68A AM. JUR. 2D *Secured Transactions* § 94 (1993).

31. WILLIAM H. LAWRENCE ET AL., *UNDERSTANDING SECURED TRANSACTIONS* § 2.03[B] (2d ed. 2000).

32. ALA. CODE § 7-9-306(2) (1997), *repealed by* 2001 Ala. Acts 481.

## 2. *The 1998 Text*

The 1998 text recognizes deposit accounts as a possibility for original collateral in section 7-9A-109. Specifically, the statute states: “[T]his article applies to: (1) a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract.”<sup>33</sup> This section appears to include a security interest in all deposit accounts. However, after looking at subsection (d), entitled “Inapplicability of article,” a point of clarification emerges. Subsection (d)(13) reads: “This article does not apply to an assignment of a deposit account in a consumer transaction.”<sup>34</sup> Assignment of a deposit account is different from a security interest in a deposit account. Assignment is the term “used to describe the transfer of a contractual right.”<sup>35</sup> The assignment of a deposit account would involve the owner of the account transferring the contractual right to withdraw the funds from the account to another person, thus alleviating himself of the right. As clearly stated by the Code, assignments of deposit accounts are not covered by Article 9.<sup>36</sup> What is covered and specifically permitted, as illustrated in the official comment, is that “except in consumer transactions, deposit accounts may be taken as original collateral under this Article.”<sup>37</sup> To understand this definition, one must understand how the 1998 text defines the term “consumer transaction.” Section 7-9A-102(a)(26) defines the term “consumer transaction” as “a transaction in which (i) an individual incurs an obligation primarily for personal, family, or household purposes, (ii) a security interest secures the obligation, and (iii) the collateral is held or acquired primarily for personal, family, or household purposes. The term includes consumer-goods transactions.”<sup>38</sup> Therefore, under the 1998 text, a creditor can obtain a security interest in a deposit account as long as the transaction is not a consumer transaction.

### *a. Perfection*

Because a creditor can obtain a security interest in a deposit account as original collateral, one must understand the process for perfecting such a security interest. Perfection is simply establishing one’s priority with respect to a piece of collateral among other secured creditors in the same collateral. A party may obtain a security interest in a piece of collateral without perfecting, only to see his interest in the collateral usurped by a more prudent creditor who has perfected. Therefore, it is important to understand how to perfect a security interest in a deposit account.

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33. ALA. CODE § 7-9A-109(a)(1) (Supp. 2001).

34. *Id.* § 7-9A-109(d)(13).

35. JOHN EDWARD MURRAY, JR., *MURRAY ON CONTRACTS* § 135 (4th ed. 2001).

36. ALA. CODE § 7-9A-109(d)(13) (Supp. 2001).

37. *Id.* § 7-9A-109 cmt. 16.

38. *Id.* § 7-9A-102(a)(26).

The 1998 text provides that the only way to perfect an interest in a deposit account is to maintain control of the account. Specifically, section 7-9A-312(b)(1) states that “a security interest in a deposit account may be perfected only by control under Section 7-9A-314.”<sup>39</sup> Section 7-9A-314 merely states how perfection by control works generally with respect to any security interest that may be perfected by control.<sup>40</sup> Section 7-9A-104, however, explains how control of a deposit account is acquired. Section 7-9A-104 states:

(a) Requirements for control. 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.

(b) Debtor’s right to direct disposition. 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.<sup>41</sup>

This statute sets out three ways for a creditor to maintain control over the deposit account, and each will be discussed herein. The most important provision of this section, however, is subsection (b), because it states that even if the debtor can spend the money in the account, a secured party may still be considered in control of the account for purposes of perfection.

As previously stated, section 7-9A-104 outlines three ways for a secured party to gain control of the deposit account. First, if the secured party is the bank with which the deposit account is maintained, then the bank will be considered to have control over the account.<sup>42</sup> This assumes that the bank and the account holder have entered into a security agreement that properly attaches the deposit account as collateral for value. If that has occurred, the bank will have perfected its security interest merely by maintaining the account for the debtor. For example, assume account holder *D* at bank *B* enters into an agreement with *B* to extend *D* a loan to pay for a new piece of equipment. *D* and *B* can enter into a security agreement where *B* extends *D* a loan, and as collateral for that loan, *B* is granted a security interest in the account *D* holds at *B*. In this situation, *B* is automatically perfected because *B* is the bank in which the deposit account is maintained. Additionally, be-

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39. *Id.* § 7-9A-312(b)(1).

40. *See id.* § 7-9A-314.

41. ALA. CODE § 7-9A-104 (Supp. 2001).

42. *Id.*

cause of subsection (b), *B* does not lose control of the account because *D* is allowed to freely move funds in and out of the account.

The second way for a secured party to maintain control of the account under section 7-9A-104 is for the secured party and the debtor to enter into an agreement with the bank where the bank will comply with the instructions of the secured party directing the disposition of the funds in the account without the further consent of the debtor.<sup>43</sup> In this situation, debtor *D* and lender *L* go to *D*'s bank, a third party, and enter into an authenticated agreement under which the bank agrees to abide by the wishes of *L* without conferring with *D*. This situation is established where *L* is not considered a joint account holder, as addressed in section 7-9A-104(a)(3). This alternative may be preferable to the third method of gaining control of an account, which is not permanent. In many states, when a party joins an account as a joint account holder, that relationship cannot be terminated without closing the account.<sup>44</sup>

Finally, the third way for a secured party to maintain control of a deposit account provided by section 7-9A-104 is where the secured party becomes the bank's customer.<sup>45</sup> This situation arises where the debtor and the secured party become joint account holders in much the same way that a husband and wife may be joint account holders of their checking account. For example, assume debtor *D* borrows money from lender *L* and enters into a security agreement giving *L* a security interest in *D*'s deposit account. In order for *L* to be perfected in the account, he must be in control of the account. *L* can accomplish this by going to the bank with *D* and becoming a joint holder of the account. This satisfies the third method of perfection by control of a deposit account because the bank would do whatever either party instructed the bank to do with the funds without consulting the other party. Further, under subsection (b), *L* would not become unperfected because *D* also maintains control of the deposit account.

### *b. Priority*

Not only do deposit accounts have their own rules for perfection, they also have their own rules for determining priority in the account. For instance, if two parties have entered into two separate security agreements with the same debtor using the debtor's deposit account as the collateral, which party has the senior interest in the account? Section 7-9A-327 of the Code of Alabama provides some guidance.<sup>46</sup> That section sets out the fol-

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43. *Id.*

44. Sara L. Johnson, Annotation, *Liability of Bank to Joint Depositors for Removal of Name from Account at Request of Other Joint Depositor*, 39 A.L.R. 4TH 1112 (1985).

45. ALA. CODE § 7-9A-104 (Supp. 2001).

46. Section 7-9A-327 states:

The following rules govern priority among conflicting security interests in the same deposit account:



lowing order for priorities: First, a secured party perfected by control has priority over a party perfected by any other method.<sup>47</sup> This situation emerges where a secured party has control over the account (i.e., joint account holder) and another party has a competing security interest obtained through proceeds deposited in the account. In this situation, the joint account holder has priority. Second, generally competing security interests are ranked according to priority in time of obtaining control.<sup>48</sup> This situation develops when the debtor adds a creditor to the debtor's deposit account as a joint account holder and later adds another creditor as a joint account holder, such that the debtor and two different creditors are simultaneously in control of the account. In this case, the first creditor would have priority over the second.

There is one exception to the two rules stated above: A bank with a security interest in an account held in its bank has priority over other secured parties exercising control except where the other secured party is a customer of the bank with regard to the same collateral account.<sup>49</sup> This exception is applicable where a bank has entered into a contract whereby the bank agrees to comply with the instructions of a secured party without first consulting the account owner, as contemplated by section 7-9A-104(a)(2). If the bank later acquires a security interest in the same deposit account, section 7-9A-327(3) gives priority to the bank even though its interest arose after the interest of the first secured party. The first secured party can protect itself by becoming a customer of the bank. If the secured party becomes a joint account holder with the debtor and later the bank acquires a security interest in the deposit account, the joint account holder would have priority over the bank.<sup>50</sup>

### III. SECURITY INTEREST IN DEPOSIT ACCOUNTS AND SETOFFS IN BANKRUPTCY

As previously discussed, an area that will be significantly impacted by the change in the treatment of deposit accounts under the 1998 text is where

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(1) A security interest held by a secured party having control of the deposit account under Section 7-9A-104 has priority over a conflicting security interest held by a secured party that does not have control.

(2) Except as otherwise provided in paragraphs (3) and (4), security interests perfected by control under Section 7-9A-314 rank according to priority in time of obtaining control.

(3) Except as otherwise provided in paragraph (4), a security interest held by the bank with which the deposit account is maintained has priority over a conflicting security interest held by another secured party.

(4) A security interest perfected by control under Section 7-9A-104(a)(3) has priority over a security interest held by the bank with which the deposit account is maintained.

*Id.* § 7-9A-327.

47. *Id.*

48. *Id.*

49. *Id.*

50. ALA. CODE § 7-9A-327 (Supp. 2001).

a prudent secured creditor takes a security interest in a debtor's deposit account(s). The 1998 text will prevent the secured party from having to identify the proceeds of sold collateral among commingled funds. Another major area impacted by the 1998 revision will be banks' use of the right to setoff in bankruptcy where banks have security interests in their customers' accounts. The Bankruptcy Code, codified at title 11 of the United States Code, provides for the protection of the right to setoff, but it does not itself create a right to setoff. Specifically, section 553 of the Bankruptcy Code states that:

[T]his title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case . . . .<sup>51</sup>

This section provides two important pieces of information. First, the Bankruptcy Code neither prohibits nor creates the right to setoff. Second, it defines "setoff," although it does so in a convoluted manner. To clarify setoff, consider the following example. Assume bank *B* lends debtor *D* \$100,000. Assume also that *D* has a checking account with a balance of \$5,000 with *B*. In this situation, *B* and *D* are both a creditor and a debtor of the other. *B* owes *D* the \$5,000 in the checking account, while *B* is owed \$100,000 from *D*. Conversely, *D* owes *B* \$100,000, and *B* owes *D* the \$5,000 in the checking account. A setoff occurs when *B* takes the \$5,000 in the checking account and lowers the balance owed to it by *D* to \$95,000. *B* has setoff the amount owed to it by the amount it owes *D*.<sup>52</sup>

When considering how deposit accounts affect the use of setoff in bankruptcy proceedings, this Comment focuses on the right to setoff with regard to banks. This is for two reasons. First, "[t]he remedy of equitable setoff is most commonly used by banks to satisfy loans made to people who are depositors as well as borrowers."<sup>53</sup> Second, with respect to deposit accounts, the most common situation for a setoff to be possible is where one party is a bank.<sup>54</sup> Under the Bankruptcy Code, a setoff will be disallowed as a preference if a setoff (or a right to a setoff) occurs within ninety days of the filing of the bankruptcy petition.<sup>55</sup> This means that a bank must accurately predict whether its customer is going to file for bankruptcy more than ninety days before the filing. This has created an unfortunate situation for both banks and their customers. Banks are forced to predict whether a bankruptcy is

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51. 11 U.S.C. § 553 (1993 & Supp. 2002).

52. For a more detailed discussion of setoff under the Bankruptcy Code, see DAVID G. EPSTEIN ET AL., BANKRUPTCY § 6-38 (1992).

53. *Id.*

54. Because each party must be both a creditor and debtor of the other, it is a rare situation where a third party has control of the account *and* is also a debtor to the account holder *and* is not a bank.

55. 11 U.S.C. § 553.

about to occur. If the bank initiates a setoff of the debt within the ninety-day period preceding bankruptcy, then the bankruptcy trustee can recover that money. If the bank initiates a setoff and no bankruptcy occurs, it risks making a valuable customer extremely dissatisfied. If, however, the bank initiates a setoff outside of the ninety-day window and bankruptcy occurs, then the bank is protected. Realistically, banks risk making a mistake two-thirds of the time.

Similarly, the debtor of the bank is put in an uncomfortable situation. If, in fact, the debtor is teetering between economic stability and bankruptcy and the bank initiates its right to setoff, the debtor is almost certainly going to be forced into bankruptcy. In fact, such an action will almost certainly guarantee bankruptcy in the near future, which likely would put the bank inside the ninety-day window in which it must return the amount of money it setoff under section 553. This situation puts customers and debtors at the mercy of their bank, an entity that may not be in the best position to judge the financial outlook of its customers.

The 1998 text helps alleviate this situation by allowing banks to create an original security interest in a non-consumer deposit account. Now, when lending money to an account holder, a prudent bank will include a security agreement giving the bank a security interest in the deposit account, which it will necessarily have perfected under Alabama Code § 7-9A-104 because it is the bank that maintains the account. By maintaining a security agreement as outlined above, the bank is not in the position of having to second guess its customers and debtors to determine if they are going to file bankruptcy in the near future. In the event the debtor does file for bankruptcy protection, the bank is a secured creditor in the deposit account, and as such, will receive either the balance of the loan or the balance of the account, whichever is less.<sup>56</sup> Additionally, so long as the security agreement is not created within ninety days of bankruptcy, it will not be treated as a preference.<sup>57</sup> The effect of this section is to allow banks to ignore (at least to some degree) whether their debtors are teetering on bankruptcy.

There remains the possibility that the debtor could remove all of the money from his account, removing the value of the bank's security. This situation is not addressed by the Bankruptcy Code or either version of Article 9. Without a security interest in the account, the bank has nothing to setoff if the debtor removes the funds. On the other hand, with a security interest in the account, the bank's security interest has no value if the debtor removes the funds. In either situation, the bank is left without a remedy. The difference, however, exists where the debtor continues to operate from the account and files for bankruptcy. Most debtors will not remove the money from the account simply to deprive the bank of its security interest because to do so would require the debtor to open a new operating account at a time

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56. See 11 U.S.C. § 506 (1993 & Supp. 2002).

57. *Id.* § 547.

when his business is struggling financially. In that situation, most debtors will be focusing on the changes needed to return the business to profitability. Consequently, the bank's security interest remains intact, and it will receive the value of the security to pay down the debt owed by the debtor.

#### IV. CONCLUSION

The two most recent versions of Article 9 are different in many ways, but arguably the most significant difference is their treatment of deposit accounts. The 1972 text expressly excludes deposit accounts from its scope while the 1998 text begins the practice of using non-consumer deposit accounts as original security for a loan. The intricacies of how the 1998 text deals with perfection in a deposit account as well as its priority structure are detailed and numerous, but they are of extreme importance to small business debtors. These debtors are the ones most likely to be affected negatively by a bank setting off a loan made to them. Under the 1998 text, however, the banks and small business debtors do not have to be concerned about whether a setoff should occur and when such an action should take place. According to the 1998 text, a bank can let its debtor file for bankruptcy with the knowledge that it is secured in the deposit accounts of the debtor. Of course, because the deposit account is typically also the business's operating account, the bank bears the risk that the value of its security interest will decline as the debtor spends money from the account to operate his bankrupt business. The bank may, however, seek protection from the bankruptcy court to prevent the loss of its interest. If the court determines that the bank lacks adequate protection that its interest will remain valuable, the court may act to protect the bank. The court could grant the bank an "additional or replacement lien to the extent of the decrease in value" of the deposit account.<sup>58</sup> By gaining an additional security interest, the bank is protected by the value of the new interest against the loss in value of the deposit account.

These protections prevent the bank from making a mistake that would force the business debtor into bankruptcy while protecting the bank's interest in the event of bankruptcy. When the drafters of the 1998 text included the possibility of securing a debt with a non-commercial deposit account, they not only remedied a difficult process of identifying commingled funds in a deposit account, they also created a situation where banks and businesses could function without having to spy on each other to predict their next financial move.

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58. 9B AM. JUR. 2D *Bankruptcy* § 1711 (1999).