Submission to Senate Legal and Constitutional Affairs Committee Inquiry into the Personal Property Securities Bill 2009

By

Professor Anthony Duggan

1. I would like to thank the committee for its invitation for me to make a submission to the inquiry. I am happy to oblige, though I should emphasize that I am writing this in haste. I have been out of the office for most of July and so I have had only a few days to look over the Bill and put these comments together. This leads to my first observation, which is that 5 weeks is an impossibly short time for inquiry and report on such a long and complex piece of legislation, even allowing for the ground the committee admirably managed to cover in its report on the previous draft. This new version is significantly different in terms of both drafting and substance and a proper appraisal would require much more time than the government's schedule has allowed for. This is probably the most important piece of commercial legislation in recent history and rushing it through is not a sensible way of proceeding.

2. I maintain the view I have expressed all along, namely that the government took the wrong approach to the drafting of this legislation. A far better approach would have been to enact legislation based closely, if not exactly, on the Canadian Model Personal Property Security Act, rather than attempting to re-invent the wheel (see Part 2 of my submission to the committee's inquiry into the previous draft). The new bill is quite a bit closer to the Canadian model than the previous draft, but there are still significant differences. On the other hand, I recognize that it is too late at this stage to go back to the drawing board and it is pointless to continue opposing the legislation on this ground. I take some comfort from the fact that the new bill provides expressly for a review at the end of 3 years. With luck, this will provide an opportunity to identify and correct mistakes that might not have occurred if the drafters had stuck more closely to the tried and tested Canadian model.

3. The Bill addresses some of the issues I raised about the previous draft (for example, the accessions provisions have been fixed, the commingled goods provision has been shortened and improved, the legislation now refers to registration of a security interest rather than to registration of the collateral and the drafting has been improved, among other things by removal of some of the more egregious instances of cross-referencing). However, as I tried to stress in my previous submissions both to the department and the committee, these problems were no more than symptomatic of a wider concern, namely that if you try to re-invent the wheel you run the risk of making mistakes. Given that the new Bill is still different in numerous respects from

the Canadian model, there is still the risk of mistakes I and others have not yet spotted.[1] Again, though, I take some comfort from the 3 year review provision.

4. Another aspect of the process that troubles me is the lack of transparency on important policy questions. One example is the special treatment the Bill gives security interests in bank accounts ("ADI accounts"). The provisions in question allow a bank to obtain perfection by control of a security interest in its customer's ADI account and perfection by control trumps perfection by other methods, including registration (s.75). One consequence is to give banks a significant competitive advantage over third party lenders. For example, assume Lender has a security interest, perfected by registration, in Debtor's account with Bank, either as original collateral or proceeds. Subsequently, Bank takes a security interest in the same account. Bank is perfected by control, simply by virtue of being the ADI (s.25(1)(a)) and, since perfection by control trumps perfection by registration, Bank has priority over Lender even though Lender's security interest was perfected first. Another, related, consequence is to undermine the publicity function of the legislation because, unlike perfection by registration or possession, perfection by control does not allow third parties to discover the bank's security interest. For example, assume Lender is negotiating for a security interest in Debtor's account with Bank. The deal depends on Lender having priority, but the perfection by control provisions mean there is no easy way for Lender to be sure of this in advance: for all Lender knows, Bank may have taken a security interest and, if so, it will have priority by virtue of being perfected by control. A register search will not help Lender because, by definition, a security interest perfected by control will not be on the register. The Bill's perfection by control provisions derive from Revised Article 9, but there are no corresponding provisions in any of the Canadian PPSAs. The issue is a controversial one in Canada for the reasons outlined above (see Appendix, below).[2] Canadian critics also point to a critical difference between Revised Article 9 and the Canadian PPSAs, namely that the Canadian PPSAs allow for perfection by registration of security interests in deposit accounts whereas Article 9 does not and, they argue, this facility makes provision for perfection by control unnecessary. I am not suggesting that the Revised

[1] An example of an issue I missed is the exclusion of consumer goods from the definition of purchase-money security interest in s.14(2)(c). The Piper Alderman submission alerted me to the point. The exclusion is misconceived and I agree with Piper Alderman that it should be removed. What else have I – and others – missed?

[2] The Revised Article 9 approach also has its critics within the U.S. itself: see, *e.g.*, Willa E. Gibson, "Banks Reign Supreme Under Revised Article 9 Deposit Accounts" (2005) 30 *Delaware Journal of Corporate Law* 819. I am attaching, as an Appendix, recent correspondence between members of the Ontario Bar Association's Personal Property Security Law Committee and others on the issue. The correspondence was inspired, in part, by the recent decision of the Supreme Court of Canada in *Caisse populaire Desjardins de L'Est de Drummond v. Canada* 2009 SCC 29, suggesting, contrary to previous assumptions, that a bank's right of set-off may constitute a security interest in its customer's account if there is also a flawed asset arrangement in place which precludes the customer from making withdrawals from the account. The point matters because if such arrangements do give the bank a security interest then, under the PPSAs as they presently stand, the bank may be subordinate to a prior perfected security interest in the same collateral. On the other hand, if the bank does not have a security interest, the PPSAs do not apply and the bank will have priority. Broadly speaking, the concept of perfection by control mimics this latter outcome.

Article 9 approach is necessarily wrong, but simply that there are important competing policy considerations and there is no indication of these having been debated – at least publicly - in Australia. The only reason I have been given for the Australian approach is that "Australian stakeholders [read banks] were strongly of the view that, like Article 9, it should be possible to perfect a security interest in an ADI account by control" (letter from Robert Patch dated 30 March 2009). Another example of transparency concerns is the decision not to include provisions relating to security interests in fixtures (see Part 5(a) of my previous submission). According to the Attorney-General's Department the reason has to do with opposition from the States. However, there is no public record of the States' arguments and no indication of how hard the Department pushed the point. The omission of provisions governing fixtures is a serious flaw, for the reasons given in my previous submission.

5. One step the Department might consider taking in mitigation of the transparency problem is to revise the Explanatory Memorandum by incorporating discussion of: (1) key policy decisions and why they were taken; and (2) key departures from the Canadian-New Zealand model and the reasons for them. The current Explanatory Memorandum is for the most part confined to explaining what the legislation means. As such, it takes the Bill as given and sheds little light on why particular policy and drafting choices were made. This additional information might help stakeholders come to grips with the legislation more quickly and it might also help justify aspects of the legislation which, read in isolation, may seem puzzling or even misconceived. The remainder of what I have to say (paras 6-14, below) relates to more detailed and technical aspects of the new Bill. Again, I should say that I have not had time to study the new Bill closely and so these are simply points I was able to identify on a quick reading.

6. The Canadian PPSAs, in common with Article 9, define personal property to include goods (among other things) and they subdivide goods into 3 categories: consumer goods, inventory and equipment. The distinction is central to the scheme of the legislation because different rules may apply depending on the category into which the goods in question fall. An important Canadian example concerns the rules relating to registration of serial-numbered goods (motor vehicles and the like). If the motor vehicle is consumer goods, the legislation requires the secured party to include the serial number in the financing statement. Failure to do so invalidates the financing statement and this, in turn, means the security interest is unperfected. On the other hand, if the vehicle is equipment or inventory inclusion of the serial number in the financing statement is optional. The reason is that security interests are commonly taken in both present and after-acquired equipment and inventory and, if the security interest is in after-acquired vehicles, by definition the secured party will not know the serial numbers at the time of completing the financing statement. However, the Canadian PPSAs also provide that if the vehicle is equipment, failure to include the serial number may result in extinguishment of the security interest if an innocent third party acquires the vehicle. The aim is to give the secured party an incentive to include the serial number if he knows it at the time of registration. There is no corresponding provision for inventory because if the vehicle in question is inventory a purchaser will

get clear title anyway, at least if the sale is in the ordinary course of the debtor's business. The Australian Bill adopts a different taxonomy. It subdivides personal property (not goods) into two categories, commercial property and consumer property. Commercial property means all personal property that is not consumer property. The Bill also subdivides personal property into inventory and non-inventory personal property. Commercial property includes both inventory and equipment but the Bill makes no reference to equipment as such. I have not had time to systematically assess the implications of the Australian approach but there is a danger that the failure to distinguish clearly between equipment and inventory as a matter of taxonomy may produce mistakes in the body of the legislation. Section 20(4) is a case in point. Section 20(4) provides that describing the collateral in the security agreement as "consumer property", "commercial property" or "equipment" is itself insufficient. However, in the absence of any provision in the statutory scheme for equipment the reader has no way of being sure what the reference in s.20(4) to equipment means. Section 44 is another possible example. This provides that a buyer or lessee obtains clear title if the collateral is serial-numbered goods and the financing statement omits or misstates the serial number. There is an exception if *the buyer or lessee* holds the property as inventory but not if she holds it as non-inventory commercial property (*viz.*, equipment). Presumably the purpose of the exception is to limit the protection s.44 provides to consumer buyers (the Explanatory Memorandum does not say) but, to achieve this result, the exception should extend to equipment as well (*viz.*, all commercial property). In any event, it would have been much easier to follow the Australian Bill if it had adhered to the tried and tested taxonomy of every other Article 9/PPSA jurisdiction. As things stand, the Australian approach requires a meticulous analysis of provisions such as s.44 to see how closely they match the priority and extinguishment rules in other jurisdictions and whether they represent the correct policy outcomes.

7. Section 47 reflects further taxonomical confusion. It provides that a buyer of low-value personal property obtains clear title if he intends to use them predominantly for personal, domestic or household purposes. The corresponding provision in the Canadian PPSAs is limited to consumer goods and it defines consumer goods to mean goods held predominantly for personal or domestic purposes. The Australian Bill defines consumer property to mean personal property held by an individual for non-business purposes. It is unclear whether the drafters' decision not to limit s.47 by reference to consumer property was a deliberate one and, if so, what it is they were hoping to achieve.

8. Section 55(4) sets out the default priority rules for competing perfected security interests in the same collateral. Priority turns on the respective "priority times" as defined in sub-s.(5) and sub-s.(6) provides that a time is a priority time for a security interest only if the security interest remains continuously perfected. Consider the following case. SP1 takes a security interest in Debtor's widget and perfects by registration on Day 1. On Day 2, SP2 takes a security interest in the same widget and also perfects by registration. On Day 3, SP1 accidentally discharges its registration. On Day 4, Debtor defaults against SP1 and SP2 and they both claim the widget. In

principle, SP1 should have priority because SP1 was perfected on Day 2 when SP2 acquired its security interest and so SP2 had the means of discovering SP1's security interest before transacting with Debtor. However, according to s.55(4), SP2 has priority because SP1 was not perfected on Day 4. A possible justification for s.55(4) is that it may avoid circular priority disputes resulting from a lapse in SP1's registration but this is at the cost of giving SP2 a windfall and there is no publicly available information as to whether the drafters took account of the trade-off. Section 59 deals directly with circular priorities. The following example illustrates its application. SP1, SP2 and SP3 each have security interests in Debtor's widget ranking in that order. Subsequently, SP1 enters into a subordination agreement with SP3. In the absence of s.59, there would be a circular priorities issue: SP1 has priority over SP2 by virtue of the statutory priority rules, SP2 has priority over SP3 also by virtue of the statute but SP3 has priority over SP1 by virtue of the subordination agreement. Section 59 displaces this outcome, in effect by overriding SP1 and SP3's subordination agreement. As a consequence of the provision, SP1 cannot subordinate its security interest to SP3 without also subordinating to SP2. There is an apparent inconsistency between this limitation and s.61 which provides that a subordination agreement is effective according to its terms between the parties: s.61 reflects a commitment to freedom of contract, whereas s.59 restricts freedom of contract in the interests of avoiding circular priority issues. Again, it is open to question whether the benefits of s.59 are worth the costs.

9. Section 62(2) sets out a special priority rule for the case where a purchase-money security interest in inventory is in competition with a non-purchase-money security interest in the same collateral. In Canada and the United States, the rule is that the purchase-money security interest has priority even if it is later in time, but the conditions are that the holder of the purchase money security interest must perfect before delivering the inventory to the debtor and it must also serve a notice on the holder of the competing security interest warning of its purchase-money security interest. The Australian Bill omits the notice requirement. Instead, it provides that the purchase-money security interest financing statement must disclose that the security interest is a purchase-money security interest. The following example illustrates the significance of the difference. Bank opens a line of credit in Debtor's favour and takes a security interest in Debtor's present and after-acquired inventory which it perfects by registration. Supplier subsequently enters into an agreement with Debtor for the supply of inventory from time to time on conditional sale terms and registers a financing statement. Under the Canadian and U.S. approach, Supplier has priority over Bank, but only if it gives Bank the statutory notice. The notice alerts Bank to the risk that it will not have priority for the inventory Debtor sources from Supplier and this information, in turn, may be relevant to Bank's decision whether to make further advances to Debtor. Under the Australian approach, since there is no notice requirement, Bank will have to check the register before making any new advance. This may not always be practical, particularly if Debtor is making frequent drawings. There is no publicly available information as to why the Australia drafters declined to follow the North American approach.

10. Section 64 provides for the case where a secured party has a security interest in Debtor's accounts as original collateral and another secured party claims the accounts as proceeds of inventory subject to a purchase money security interest. For example, SP1 supplies Debtor with inventory on conditional sale terms and registers a financing statement. Subsequently, SP2 makes Debtor a loan secured on Debtor's present and future accounts receivable and registers a financing statement. Debtor makes a sale to Customer on 90 day terms. Debtor defaults and SP1 claims Customer's account as proceeds of the inventory while SP2 claims it as original collateral. In all other Article 9/PPSA jurisdictions, SP1 has priority. By contrast, s.64 gives SP2 priority, even though SP2 is second in time, on condition that SP2 gives SP1 prior notice of its security interest. The idea behind the notice requirement, presumably, is to give SP1 an opportunity to cut its losses. However, it is not obvious what SP1 might do upon receiving a notice. Subject to any provision to the contrary in its contract with Debtor, it cannot take back inventory it has already supplied Debtor and it cannot call in the debt. One option might be to refuse further supplies but, again, this will depend on the terms of SP1's contract with Debtor and, in any event, it assumes that the contract is for the provision of inventory from time to time rather than for a one-off supply. Section 64(3) tries to sugar-coat the pill by giving SP1 a claim to the new value provided by SP1. However this assumes that the new value is traceable which may not be the case if, for example, Debtor uses the money to pay wages or taxes. It might be noted in passing that while s.64 imposes a notice requirement which, for the reasons just explained, may be of limited use to SP1, s.62 has no notice requirement even though, in the case to which s.62 applies, a notice may be useful.

11. Previous drafts of the Bill defined registration by reference to registration of the collateral, rather than the security interest. This approach is open to criticism for the reasons set out in Part 3(c) of my submission to the previous inquiry. The new draft corrects the problem: registration is now defined to mean a registered financing statement with respect to a security interest (s.10). Likewise, s.150 now provides for registration of a financing statement with respect to a security interest and s.153 deals with the content of a financing statement with respect to a security interest. However, vestiges of the previous fallacy remain. For example, s.151 refers to registration of a financing statement "that describes collateral" and to the secured party's belief that "the collateral secures" an obligation. For consistency, the references should be to a financing statement "with respect to a security interest" and a belief that "the security interest" secures an obligation. Likewise, s.160 talks about registration of "a description of collateral" when the reference should be to registration of "the security interest". On a related matter, the Bill is inconsistent in its references to the subject-matter of a security interest: sometimes it uses the expression "collateral" (defined in s.10) (*e.g.*, ss 151, 153, 160), while at other times it refers to the personal property to which the financing statement relates (*e.g.*, s.152) or "personal property" described in a registration (s.161). In the interests of both clarity and verbal economy, it would be better to use the expression "collateral", as defined in s.10, throughout.

12. The previous draft contained no conflict of laws provisions (see Part 4(b) of my earlier submission). The new version rectifies this omission (see new Part 7.2). The new provisions are similar in many respects to the conflict of laws provisions in the Canadian and New Zealand PPSAs, but there are some differences. For example, s.239 (3) provides that, with respect to a security interest in intellectual property, the governing law is the law of the jurisdiction under which the intellectual property is granted, whereas in Canada the governing law is the place of the debtor's location. Likewise, with respect to a security interest in an ADI account, the governing law is the law of the jurisdiction that governs the ADI account (s.239(4)), whereas in Canada, the rule is that the law of the jurisdiction in which the debtor is located applies. Section 240 enacts a single set of rules for security interests in financial property, whereas the Canadian PPSAs have different rules depending on whether the security interest is a possessory or non-possessory one. I have not had time to form a view on these points. There are no conflicts rules in the Bill for security interests in investment property. This omission should be rectified.

13. Section 275 provides for the making of follow-up inquiries by register searchers. For example, it allows the searcher in certain circumstances to ask the secured party to provide a copy of the security agreement. Section 275(9) lists the persons entitled to make such requests. The list does not include a prospective secured party. Assume SP2 is negotiating with Debtor for a security interest in Debtor's widget. SP2 conducts a register search and discovers that SP1 has registered a financing statement indicating that SP1 may have a security interest in the same widget. As s.275 is presently drafted, SP2 has no right to request further information from SP1 which would either confirm or dismiss this possibility. Instead, SP2 must enlist Debtor to make the request on its behalf which may involve additional transactions costs. The s.275(9) list includes "an execution creditor with an interest in the collateral", but whether this includes a *prospective* execution creditor is open to question because it could be argued that a party who is merely contemplating execution proceedings does not have an interest in the collateral. In that case, the prospective execution creditor would have to enlist the debtor's help to make the request on its behalf but, for obvious reasons, the debtor is unlikely to be co-operative.

14. Section 339 is a convoluted provision that makes heavy weather of a relatively minor job. The purpose of the provision is to make it clear that references in other legislation to a floating charge include the new PPSA equivalent. As indicated in Part 4(b) of my previous submission, it seems to me the provision could be reduced to about 3 lines by saying something like: "A reference to a floating charge in any statute means a security interest that by the operation of this Act is functionally equivalent to a floating charge, whether or not the security agreement describes the security interest as a floating charge". Aside from this point, the repeated references in s.339 to "attachment" are confusing because, by definition, a floating charge does not attach until crystallization and it is a contradiction in terms to speak of a floating charge attaching to collateral in advance of crystallization (again, see Part 4(b) of my previous submission).

15. The enforcement provisions in Chapter 4 of the Bill do not apply if the debtor is in receivership (s.116). According to the Explanatory Memorandum, the reason is that Part 5.2 of the Corporations Act 2001 (Cth) enacts comprehensive rules governing receivers and controllers. However, the appointment of a receiver does not depend on the debtor being a corporation and s.116 of the Bill is not limited to corporate receiverships. Furthermore, as a consequence of s.116, a different set of enforcement rules will apply depending on whether the secured party opts to appoint a receiver. In principle, there can be no justification for this. In substance, if not legal form, a receiver is the secured party's agent and so the same enforcement rules should apply. To the extent that the enforcement rules in Chapter 4 of the Bill are different from the rules governing receivers in the Corporations Act, parties may behave opportunistically. For example, a secured party might appoint a receiver to obtain some perceived advantage under the Corporations Act even though a receivership is not otherwise warranted. Conversely, a secured party might decide against appointing a receiver simply because it may be better off if the PPSA enforcement provisions apply. From the debtor's perspective, it makes no sense – and it is potentially unfair – to have different enforcement regimes depending on whether or not the secured party has appointed a receiver: if the debtor's goods are being repossessed, for example, why should it matter whether the secured party does the repossession itself or appoints a receiver to do the job? For these reasons, the Ontario PPSA, for example, takes the opposite tack to the Australian Bill: it defines "secured party" to include a receiver for the purposes of the main enforcement provisions. The upshot is that the same rules apply regardless of whether the secured party chooses to act through a receiver or not. Aside from these policy considerations, it is untidy and a waste of readers' resources to divide enforcement issues between two separate statutes. The PPSA is supposed to codify secured transactions law and it is inconsistent with the codification objective to leave key matters outside the statute. I suspect the government's response to all this might be that there is not enough time or political will to make the necessary amendments to both the Bill and the Corporations Act. If that is the case, then at least the issue should be put high on the agenda for the 3 year review.

Anthony Duggan

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1 August 2009

Appendix

Canadian Correspondence on Perfection by Control of Security Interests in Deposit Accounts

(In Reverse Sequence)

From: "Catherine Walsh, Prof." <catherine.walsh@mcgill.ca>
To: Margaret Grottenthaler <MGrottenthaler@stikeman.com>,
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"Roderick A. Macdonald, Prof." <roderick.macdonald@mcgill.ca>
Date: Mon, 6 Jul 2009 20:03:30 -0400
Subject: RE: More on ISDA's Potental Influence over Canadian Policy Responses to Security in Deposit Accounts
Thread-Topic: More on ISDA's Potental Influence over Canadian Policy Responses to Security in Deposit Accounts
Thread-Index: AQHJ/pZbAHio2BoixECsfwS37sUMGA==
Accept-Language: en-US
X-MS-Has-Attach:
X-MS-TNEF-Correlator:

acceptlanguage: en-US
X-PMX-Version: 5.4.2.338381, Antispam-Engine: 2.6.0.325393, Antispam-Data: 2009.7.6.235715
X-PMX-Version: 5.4.2.338381, Antispam-Engine: 2.6.0.325393, Antispam-Data: 2009.6.15.190422
X-McGill-WhereFrom: Internal

Dear Colleagues:

1. In company with Margaret Grottenthale, I am confident that John Cameron has expressed the ISDA position correctly.

2. However, does ISDA automatically represent the policy position we want to pursue in Canada?

3. As you know already, I agree with Mr Cameron about the need for clarity regarding the status of set-off as a security right. I would only add that this is an issue of concern beyond just financial institutions - all continuing commercial finance relationships are implicated - so we need to take time to consider the optimal outcome.

4. Unlike Mr. Cameron, I think that resolution of the set-off issue should not be confused with the issue of whether it is necessary or advisable - as ISDA advocates - to adopt the full range of perfection and priority control rules concerning bank accounts set out in Article 9.

5. In particular, and with respect, I do not agree with Mr. Cameron when he says that ISDA's proposal to amend the PPSA to incorporate the UCC article 9 control rules would simply confirm or clarify existing Canadian law. In fact, these changes would radically change our collective legal status quo.

6. Under current Canadian [provincial] law [both PPSA and Civil Code], a bank account is just another type of receivable or claim owed by the bank to the customer. As with any other type of receivable or claim, a secured creditor who wants to take a security interest in a debtor's bank account has to register to achieve third party effectiveness, and priority is determined by the residual first to register rule (subject to the depository's bank's right of set-off). If an external secured creditor is concerned about having its collateral - the receivable owed by the bank - reduced by reason of the the depository bank's right of set-off, the solution is to have the account opened in the name of the secured creditor (or in both names with the secured creditor having a right of sign-off) so that the bank's obligation is owed to the secured creditor- not the debtor. If the depository bank is concerned about the extent of the efficacy of its right of set off as against a secured creditor on the account, it can bolster its rights by taking and registering a security right in the account, or there is a need to escalate to this level of protection, similarly insisting that the account be opened in its own name or jointly with the debtor.

6. The approach to deposit accounts in Article 9 is very different. First, registration is not available as a means of perfection. Second, the depository bank always always wins

while being immunized from the usual rules on attachment and disclosure (in fact the depository bank need never disclose anything to anybody). The external secured creditor (who needs to enter into a tripartite agreement with the depository bank and the debtor of dubious legal effect) is very much a second-run. So there is never a mechanism for publicity to third parties generally or specifically. Third, the only "exception" is one we already recognize in Canadian law - open the account in the name of the secured creditor so that the obligation is owed by the bank to the secured creditor directly (this is really not an exception, since under this approach, the debtor is never owed the obligation that it purports to be using as collateral and so there is no need for publicity to third parties who cannot by definition be misled).

7. We've done OK historically with our existing rules. They're part of a matrix of public and private law rules that emphasize transparency, universality of treatment, and therefore very limited special interest (self-regulation) exceptions. The U.S., when it comes to the equivalent matrix, not so much - lots of examples of exceptions - within and outside of article 9 - that have turned out to be misguided in hindsight (so score 1 for us for erring on the side of universal rules).

8. Let's take our time here folks. If no one can explain precisely what's broken about what we've been doing in Canada (and considering a generally broken U.S. and global system against which we don't look too bad), why should we 'urgently' adopt a reform wish list from ISDA that predates the current crisis?

9. I don't at the same time reject the need for clarification of Canadian law - I just want to be sure that clarification does not become an excuse for thoughtless imitation.

9. Personally, I'd rather hear about reform proposals that speak directly to the present crisis and its future resolution (vs. 'let's just copy what the U.S. does - business as usual).

Catherine

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From: Margaret Grottenthaler [MGrottenthaler@stikeman.com]
Sent: Monday, July 06, 2009 10:52 AM
To: Cameron, John; Catherine Walsh, Prof.; Rob Scavone; David.Denomme@cit.com; CHRIS.BURR@blakes.com; MICHAEL.BURKE@blakes.com; allen.doppelt@ontario.ca; tony.duggan@utoronto.ca; bgeva@osgoode.yorku.ca; blossom@oba.org; dgrieve@blaney.com; efriedman@langmichener.ca; harvey@chaitons.com; hwiercin@mccarthy.ca; j.ziegel@utoronto.ca; jbabe@millerthomson.ca; jclancy@oba.org; michelle.Kalsbeek@ontario.ca; nsaxe@heenan.ca; lawrhm@uwo.ca; mclaren@mckenzielake.com; ronald.cuming@usask.ca; SBenIshai@osgoode.yorku.ca; tbuckwold@law.ualberta.ca; w.barnard@ucda.org; wende.rapson@gmacfs.com; PAUL.WICKENS@blakes.com
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Subject: RE: Control over Deposit Accounts

John expresses the ISDA position correctly. It's also a credit issue for financial institutions as givers or receivers of cash collateral. With no confidence that set-off will give effective priority it will either become unacceptable collateral or will be heavily discounted.

-----Original Message-----
From: Cameron, John [mailto:jcameron@torys.com]
Sent: June 30, 2009 7:17 PM
To: Catherine Walsh, Prof.; Rob Scavone; David.Denomme@cit.com; CHRIS.BURR@blakes.com; MICHAEL.BURKE@blakes.com; allen.doppelt@ontario.ca; tony.duggan@utoronto.ca; bgeva@osgoode.yorku.ca; blossom@oba.org; dgrieve@blaney.com; efriedman@langmichener.ca; harvey@chaitons.com; hwiercin@mccarthy.ca; j.ziegel@utoronto.ca; jbabe@millerthomson.ca; jclancy@oba.org; michelle.Kalsbeek@ontario.ca; nsaxe@heenan.ca; lawrhm@uwo.ca; mclaren@mckenzielake.com; ronald.cuming@usask.ca; SBenIshai@osgoode.yorku.ca; tbuckwold@law.ualberta.ca; w.barnard@ucda.org; wende.rapson@gmacfs.com; PAUL.WICKENS@blakes.com
Cc: jmdeschamps@mccarthy.ca; Margaret Grottenthaler; Roderick A. Macdonald, Prof.
Subject: RE: Control over Deposit Accounts

Catherine,

1. Because the SCC decision suggests you've got to treat a cash collateral right of set-off as a security interest and register under the PPSA. If you've got to register, then you've got to rely on the priority rules based on registration, and set-off doesn't give the lender the priority it wants and reasonably expects. That's the feature of the SCC decision which prompted me to write on this topic today.

2. I hesitate to try to explain what ISDA is asking for because I'm not acting for them. As I read their letter, they want to have the same degree of certainty about the perfection and priority of a security interest in cash, as they have for securities. A high degree of certainty is necessary so that banks can be confident to get the best capital adequacy treatment in relation to their net exposure under swaps. This has nothing to do with the use of cash collateral in their own business.

I do see that they want the PPSA to be amended to clarify that cash collateral (i.e. money on deposit with the secured creditor in this case) can be used in the same fashion as securities, where pledged to a lender. I personally don't see any doubt about that question under Canadian law because the deposit itself creates a debtor/creditor relationship under which the bank is completely free to use the cash however it wants. Based on this view of the law, I am not fussed about their request in relation to use of cash collateral.

Kind regards, John.

-----Original Message-----
From: Catherine Walsh, Prof. [mailto:catherine.walsh@mcgill.ca]

Sent: June 30, 2009 6:54 PM
To: Cameron, John; Rob Scavone; David.Denomme@cit.com; CHRIS.BURR@blakes.com; MICHAEL.BURKE@blakes.com; allen.doppelt@ontario.ca; tony.duggan@utoronto.ca; bgeva@osgoode.yorku.ca; blossom@oba.org; dgrieve@blaney.com; efriedman@langmichener.ca; harvey@chaitons.com; hwiercin@mccarthy.ca; j.ziegel@utoronto.ca; jbabe@millerthomson.ca; jclancy@oba.org; michelle.Kalsbeek@ontario.ca; nsaxe@heenan.ca; lawrhm@uwo.ca; mclaren@mckenzielake.com; ronald.cuming@usask.ca; SBenIshai@osgoode.yorku.ca; tbuckwold@law.ualberta.ca; w.barnard@ucda.org; wende.rapson@gmacfs.com; PAUL.WICKENS@blakes.com
Cc: jmdeschamps@mccarthy.ca; Margaret Grottenthaler; Roderick A. Macdonald, Prof.
Subject: RE: Control over Deposit Accounts

John:

1. If you think contractual set-off is already effective in insolvency, why advocate for an Article 9 type automatic control and super priority rule for depository institutions regarding their deposit accounts?

2. I don't understand your response to my 2d comment. ISDA is lobbying to enable banks to use the deposit account receivables owed to their customers as collateral for their own borrowing transactions. The USTA sanctions this indirectly for securities insofar as an intermediary's transfer or pledge of customer securities always trumps the rights of the customer and the customer's secured creditor. This policy has proved to be controversial internationally and was ultimately rejected by the proposed UNIDROIT Convention on Intermediated Securities (which leaves the issue to national law). Let us please not compound the USTA error by extending it to bank deposit accounts within Canada.

Catherine

From: Cameron, John [jcameron@torys.com]
Sent: Tuesday, June 30, 2009 6:07 PM
To: Catherine Walsh, Prof.; Rob Scavone; David.Denomme@cit.com; CHRIS.BURR@blakes.com; MICHAEL.BURKE@blakes.com; allen.doppelt@ontario.ca; tony.duggan@utoronto.ca; bgeva@osgoode.yorku.ca; blossom@oba.org; dgrieve@blaney.com; efriedman@langmichener.ca; harvey@chaitons.com; hwiercin@mccarthy.ca; j.ziegel@utoronto.ca; jbabe@millerthomson.ca; jclancy@oba.org; michelle.Kalsbeek@ontario.ca; nsaxe@heenan.ca; lawrhm@uwo.ca; mclaren@mckenzielake.com; ronald.cuming@usask.ca; SBenIshai@osgoode.yorku.ca; tbuckwold@law.ualberta.ca; w.barnard@ucda.org; wende.rapson@gmacfs.com; PAUL.WICKENS@blakes.com
Cc: jmdeschamps@mccarthy.ca; Margaret Grottenthaler; Roderick A. Macdonald, Prof.
Subject: RE: Control over Deposit Accounts

1. In my view (apart from the effect of a peculiar provision in the WURA), contractual set-off is effective in insolvency. I don't think the proposal to allow perfection and priority by control eliminates any significant requirements in relation to set-off. Virtually every form of business bank agreement I have seen includes a contractual right of set-off. I don't see a significant policy issue.

2. I don't think the banks are using the debt as capital. As I understand the ISDA letter, their goal as to capital adequacy is to ensure that cash collateral is given equivalent treatment as securities for the purposes of measuring a bank's potential credit exposure under a swap contract. However, I defer to others as to the capital adequacy rules.

Kind regards, John.

John Cameron
>Torys LLP

-----Original Message-----
From: Catherine Walsh, Prof. [mailto:catherine.walsh@mcgill.ca]
Sent: June 30, 2009 5:49 PM
To: Cameron, John; Rob Scavone; David.Denomme@cit.com; CHRIS.BURR@blakes.com; MICHAEL.BURKE@blakes.com; allen.doppelt@ontario.ca; tony.duggan@utoronto.ca; bgeva@osgoode.yorku.ca; blossom@oba.org; dgrieve@blaney.com; efriedman@langmichener.ca; harvey@chaitons.com; hwiercin@mccarthy.ca; j.ziegel@utoronto.ca; jbabe@millerthomson.ca; jclancy@oba.org; michelle.Kalsbeek@ontario.ca; nsaxe@heenan.ca; lawrhm@uwo.ca; mclaren@mckenzielake.com; ronald.cuming@usask.ca; SBenIshai@osgoode.yorku.ca; tbuckwold@law.ualberta.ca; w.barnard@ucda.org; wende.rapson@gmacfs.com; PAUL.WICKENS@blakes.com
Cc: jmdeschamps@mccarthy.ca; Margaret Grottenthaler; Roderick A. Macdonald, Prof.
Subject: RE: Control over Deposit Accounts

John:

Thank you for the clarification.

Two questions:

(1) As you note, set-off is narrower than an automatic security right in favour of the depository institution which is why lock box arrangements have come into common use. On what policy basis do you support elimination of the need to satisfy set-off rules in insolvency situations?

(2) You state that the SCC decision has created "a more cumbersome situation for cash collateral accounts, where the bank itself wants to use money on deposit with the bank as cash collateral." As you know, the bank is an account debtor to the customer. Yet you advocate that a bank should be able to use its debt obligations to its customers as though

these represented bank capital. How does your proposed rule correlate with the capital adequacy requirements imposed by banking law? I recognize that the USTA effectively supports the re-pledging of securities credited to the account of an intermediary for a customer to the intermediary's own account so there is a precedent. But please let's not compound the USATA error by allowing banks to to treat customer deposit accounts as bank collateral eligible for re-pledging.

Returning to my original concern, how does your proposal (to implement UCC Article 9 fully) square with banking regulations on capital adequacy?

Catherine.

From: Cameron, John [jcameron@torys.com]
Sent: Tuesday, June 30, 2009 5:05 PM
To: Catherine Walsh, Prof.; Rob Scavone; David.Denomme@cit.com; CHRIS.BURR@blakes.com; MICHAEL.BURKE@blakes.com; allen.doppelt@ontario.ca; tony.duggan@utoronto.ca; bgeva@osgoode.yorku.ca; blossom@oba.org; dgrieve@blaney.com; efriedman@langmichener.ca; harvey@chaitons.com; hwiercin@mccarthy.ca; j.ziegel@utoronto.ca; jbabe@millerthomson.ca; jclancy@oba.org; michelle.Kalsbeek@ontario.ca; nsaxe@heenan.ca; lawrhm@uwo.ca; mclaren@mckenzielake.com; ronald.cuming@usask.ca; SBenIshai@osgoode.yorku.ca; tbuckwold@law.ualberta.ca; w.barnard@ucda.org; wende.rapson@gmacfs.com; PAUL.WICKENS@blakes.com
Cc: jmdeschamps@mccarthy.ca; Margaret Grottenthaler; Roderick A. Macdonald, Prof.
Subject: RE: Control over Deposit Accounts

I intend that we follow the Article 9 approach. Lock boxes (as defined below) would be too narrow because they would not include a cash collateral account established by the lender. More generally, I don't share Catherine's concerns about transparency because the nature of the asset (cash in a bank account) has been historically subject to competing claims, including the rights of set-off or consolidation of accounts in favour of the banker. Every lender knows their in a messy situation if they have to trace money into a bank account. That's why the practice has evolved to use lock-boxes more frequently in the last few years.

I think the SCC decision has created a more cumbersome situation for cash collateral accounts, where the bank itself wants to use money on deposit with the bank as cash collateral. Allowing perfection by control addresses that situation. Affording priority would be useful for the reasons mentioned in the ISDA letter.

I don't think third party lenders (e.g. asset based lenders) should be concerned about allowing perfection by control because those lenders often require lock-box arrangements

where the cash proceeds are important to them. In those cases, asset based lenders will be able to obtain the priority they want through a control agreement.

Kind regards, John.

John Cameron
>Torys LLP

-----Original Message-----
From: Catherine Walsh, Prof. [mailto:catherine.walsh@mcgill.ca]
Sent: June 30, 2009 4:40 PM
To: Cameron, John; Rob Scavone; David.Denomme@cit.com; CHRIS.BURR@blakes.com; MICHAEL.BURKE@blakes.com; allen.doppelt@ontario.ca; tony.duggan@utoronto.ca; bgeva@osgoode.yorku.ca; blossom@oba.org; dgrieve@blaney.com; efriedman@langmichener.ca; harvey@chaitons.com; hwiercin@mccarthy.ca; j.ziegel@utoronto.ca; jbabe@millerthomson.ca; jclancy@oba.org; michelle.Kalsbeek@ontario.ca; nsaxe@heenan.ca; lawrhm@uwo.ca; mclaren@mckenzielake.com; ronald.cuming@usask.ca; SBenIshai@osgoode.yorku.ca; tbuckwold@law.ualberta.ca; w.barnard@ucda.org; wende.rapson@gmacfs.com; PAUL.WICKENS@blakes.com
Cc: jmdeschamps@mccarthy.ca; Margaret Grottenthaler; Roderick A. Macdonald, Prof.
Subject: RE: Control over Deposit Accounts

Dear all:

I agree with John that a legislative amendment recognizing lock box deposit account arrangements as sufficient for perfection and even super-priority - might be useful (by lock box arrangements, I mean deposit accounts opened and maintained in the name of the secured creditor either exclusively or jointly with the debtor). As I have said before, I think current law - both in Quebec and in PPSA jurisdictions - already supports the effectiveness of this kind of arrangement but a statutory clarification could be reassuring.

For reasons already stated in earlier emails, I do not agree with legislation that would implement the full UCC article 9 concept of control for bank accounts - i.e. automatic super priority for depository institutions, "control agreements" with 3d p. secured creditors, no obligation for a bank to disclose that it has a security interest in its customers' accounts or that it has entered into a control agreement with respect to customer accounts, no option for perfection by registration, etc. Transparency please!

It is unclear to me whether John is supporting ISDA's complete wish list (presumably, the full revised Article 9 approach) or just wants legislative confirmation that the lock box type arrangement currently used in practice is legally effective.

Catherine

From: Cameron, John [jcameron@torys.com]

Sent: Tuesday, June 30, 2009 12:46 PM
To: Rob Scavone; David.Denomme@cit.com; CHRIS.BURR@blakes.com; MICHAEL.BURKE@blakes.com; allen.doppelt@ontario.ca; tony.duggan@utoronto.ca; bgeva@osgoode.yorku.ca; blossom@oba.org; dgrieve@blaney.com; efriedman@langmichener.ca; harvey@chaitons.com; hwiercin@mccarthy.ca; j.ziegel@utoronto.ca; jbabe@millerthomson.ca; jclancy@oba.org; michelle.Kalsbeek@ontario.ca; nsaxe@heenan.ca; lawrhm@uwo.ca; mclaren@mckenzielake.com; ronald.cuming@usask.ca; SBenIshai@osgoode.yorku.ca; tbuckwold@law.ualberta.ca; w.barnard@ucda.org; wende.rapson@gmacfs.com; PAUL.WICKENS@blakes.com
Cc: jmdeschamps@mccarthy.ca; Margaret Grottenthaler; Catherine Walsh, Prof.
Subject: Control over Deposit Accounts - Significance of SCC Decision in Desjardins de l'Est de Drummond v. Canada

Dear all,

I think one of the most significant concerns flowing from the SCC decision arises in the context of using bank accounts or other deposits as security for swap contracts or other obligations. It will now be very difficult to implement those arrangements without setting up an account which qualifies as a securities account for the purposes of the STA. As a result, implementation of the reform advocated by ISDA in their letter dated June 8, 2009 to the Ontario and Alberta governments becomes more significant.

I consulted with colleagues who act frequently for borrowers and lenders in connection with secured financings, as to whether allowing for perfection by control of a deposit account would increase difficulty negotiating intercreditor agreements. Those who expressed a view to me believe (and I agree) that this reform would make it easier -- not harder -- to negotiate these agreements. In practice, lenders who want priority over cash proceeds of collateral require that those proceeds be paid into accounts under their control. Lock box arrangements have become much more common in Canada in recent years. The proposed reform to allow perfection and priority based on control would dovetail with these practices.

As to addressing the SCC decision itself, I agree with Catherine's views (expressed in her e-mail below) that it will be difficult draft a bright line statutory test to determine whether a right of set-off creates a security interest.

Kind regards, John.

John Cameron
Torys LLP

-----Original Message-----
From: Catherine Walsh, Prof. [mailto:catherine.walsh@mcgill.ca]
Sent: June 26, 2009 6:49 PM

To: Rob Scavone; 'David.Denomme@cit.com'; CHRIS.BURR@blakes.com; MICHAEL.BURKE@blakes.com; allen.doppelt@ontario.ca; tony.duggan@utoronto.ca; bgeva@osgoode.yorku.ca; blossom@oba.org; dgrieve@blaney.com; efriedman@langmichener.ca; harvey@chaitons.com; hwiercin@mccarthy.ca; j.ziegel@utoronto.ca; jbabe@millerthomson.ca; jclancy@oba.org; michelle.Kalsbeek@ontario.ca; nsaxe@heenan.ca; Cameron, John; lawrhm@uwo.ca; mclaren@mckenzielake.com; ronald.cuming@usask.ca; SBenIshai@osgoode.yorku.ca; tbuckwold@law.ualberta.ca; w.barnard@ucda.org; wende.rapson@gmacfs.com; PAUL.WICKENS@blakes.com
Cc: jmdeschamps@mccarthy.ca
Subject: RE: Desjardins de l'Est de Drummond v. Canada - distinction between security interest and rights of set-off/compensation

I agree wholeheartedly with Rob's concerns. Unfortunately, this is a case where the DISSENT got it right.

However, crafting an amendment to address the negative implications for the PPSA will prove very challenging. While the majority decision pays formal service to the security interest/set-off distinction, the reasoning makes it very difficult to articulate a bright line statutory dividing line. Simply excluding set-off/compensation from the concept of a security interest in the PPSA would be insufficient since this would only beg the question from the perspective of the majority.

The most obvious practical concerns are with the increased registration burden and consequent risk.

But the reasoning of the majority also threatens - by its very loose, intent-dependent, and result-oriented concept of what gives rise to a property right in a personal obligation- to open up the concept of a security interest to many other transactions that involve purely personal/ contractual reciprocal obligations.

From: Rob Scavone [Rob.Scavone@mcmillan.ca]
Sent: Monday, June 22, 2009 11:24 AM
To: 'David.Denomme@cit.com'; Catherine Walsh, Prof.; CHRIS.BURR@blakes.com; MICHAEL.BURKE@blakes.com; allen.doppelt@ontario.ca; tony.duggan@utoronto.ca; bgeva@osgoode.yorku.ca; blossom@oba.org; dgrieve@blaney.com; efriedman@langmichener.ca; harvey@chaitons.com; hwiercin@mccarthy.ca; j.ziegel@utoronto.ca; jbabe@millerthomson.ca; jclancy@oba.org; michelle.Kalsbeek@ontario.ca; nsaxe@heenan.ca; jcameron@torys.com; lawrhm@uwo.ca; mclaren@mckenzielake.com; ronald.cuming@usask.ca; SBenIshai@osgoode.yorku.ca; tbuckwold@law.ualberta.ca; w.barnard@ucda.org; wende.rapson@gmacfs.com; PAUL.WICKENS@blakes.com
Subject: Decision in Desjardins de l'Est de Drummond v. Canada and rights of set-off

The Supreme Court of Canada has released its decision in Caisse populaire Desjardins de l'Est de Drummond v. Canada, 2009 SCC 29 - http://scc.lexum.umontreal.ca/en/2009/2009scc29/2009scc29.html. The Court dismissed an appeal from the Federal Court of Appeal which held that the Crown was entitled to recover the amounts due and the interest paid at the rate provided for in ss. 36(2) and 37(2) of the Federal Courts Act. The Court found that a contract providing for a right to compensation (in Quebec) or a right of set-off (in the common law provinces) also gives rise to a security interest within the meaning of s. 224(1.3) of the Income Tax Act (Canada). Since the definition of security interest in s. 224(1.3) of the Income Tax Act is similar to that in provincial PPSAs, this decision could have the unfortunate effect of providing a basis for claiming that a right of set-off creates a security interest within the meaning of the PPSA requiring registration. This has never been the law, and the dissent correctly points out that a right of set off does not create a property interest in or real (in rem) right to the debtor's property and so cannot satisfy the definition of security interest, even though its effect may be analogous to a security interest. Does this mean we now have to file financing statements for every agreement that creates a right of set-off?

Should the committee consider recommending an amendment to the definition of security interest making it clear that it excludes rights of set-off, compensation and the like?

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-----Original Message-----

From: David.Denomme@cit.com [mailto:David.Denomme@cit.com]
Sent: Tuesday, June 16, 2009 1:00 PM
To: catherine.walsh@mcgill.ca; CHRIS.BURR@blakes.com; MICHAEL.BURKE@blakes.com; allen.doppelt@ontario.ca; tony.duggan@utoronto.ca; bgeva@osgoode.yorku.ca; blossom@oba.org; dgrieve@blaney.com; efriedman@langmichener.ca; harvey@chaitons.com; hwiercin@mccarthy.ca; j.ziegel@utoronto.ca; jbabe@millerthomson.ca; jclancy@oba.org; michelle.Kalsbeek@ontario.ca; nsaxe@heenan.ca; jcameron@torys.com; lawrhm@uwo.ca; mclaren@mckenzielake.com; Rob Scavone; ronald.cuming@usask.ca; SBenIshai@osgoode.yorku.ca; tbuckwold@law.ualberta.ca; w.barnard@ucda.org; wende.rapson@gmacfs.com; PAUL.WICKENS@blakes.com
Subject: RE: PPSL Committee Meeting - June 16, 2009 - bank accounts/control issue

For those of you with access to the Committee's website, I'd note that the article Catherine refers to was already posted by Rob Scavone in the "Deposit Control Working Group" folder (in the "Shared Documents" area), together with a good amount of other material on this topic. Sent in the interests of saving a download for those interested....

-----Original Message-----
From: Catherine Walsh, Prof. [mailto:catherine.walsh@mcgill.ca]
Sent: Tuesday, June 16, 2009 12:25 PM
To: BURR, CHRIS; BURKE, MICHAEL; ALLEN DOPPELT; ANTHONY DUGGAN; BENJAMIN GEVA; BLOSSOM T. PANGOWISH; Denomme, David; DEBORAH S. GRIEVE; ERIC B.
FRIEDMAN; HARVEY CHAITON; HENRY J.P. WIERCINSKI; JACOB S. ZIEGEL; JENNIFER E. BABE; Jonathan Clancy; Michelle Kalsbeek; NEIL SAXE; R. JOHN CAMERON; RICHARD H. McLAREN; Richard McLaren (2); ROBERT SCAVONE; Ron Cuming; STEPHANIE BEN-ISHAI; Tamara Buckwold; WARREN BARNARD; WENDE RAPSON; WICKENS, PAUL
Subject: RE: PPSL Committee Meeting - June 16, 2009 - bank accounts/control issue

Colleagues:

The conclusion to the following U.S. article - reproduced further below - reflects my view on the bank accounts/control issue (control acceptable only if limited to exclusive control, i.e. the functional equivalent of physical possession). However, the full article is well worth a read - carefully covers all the issues (free download from ssrn.com)

Gibson , Willa E., Banks Reign Supreme under Revised Article 9 Deposit Account Rules. Delaware Journal of Corporate Law, Vol. 30, No. 3, pp.
819-862, 2005; U of Akron Legal Studies Research Paper No. 05-21.
Available at SSRN: http://ssrn.com/abstract=894153

...
VIII. CONCLUSION

The deposit account rules adopted by Revised Article 9 provide banks with greater sovereignty over the deposit accounts they maintain.
This is necessary to protect the liquidity of the accounts against unbridled lending. The rules fail to provide safeguards to insure that banks do not abuse their authority. The rules also fail to consider how bank sovereignty will affect involuntary lien creditors that historically have had access to deposit accounts to satisfy liens.
Revised Article 9 contains no discussion concerning these matters.
Rather, it only summarily states that deposit accounts were included to increase financing opportunities. Control rules were adopted presumably to prevent non-reliance lending. Moreover, the stated reason for the inclusion of deposit accounts is somewhat disingenuous in light of the restrictive perfection rules. Banks emerge as the only winner because they can use their new found power to protect their financial interests.

The most effective way to promote deposit account financing without endangering the payment system and without squeezing out involuntary creditors is to limit perfection to exclusive control. This method was endorsed by courts under the common law without disruption to the payment system. Applying exclusive control, outside creditors would be required to establish special accounts to collateralize deposit accounts for financing purposes. Banks would not have automatic perfection in any of the accounts they maintain. Like all other creditors, banks would have to establish special accounts to collateralize deposit accounts, and they could exercise setoff against both special accounts and any operating accounts they maintain on behalf of their depositors. Like Revised Article 9 rules, banks would be restricted from exercising setoff rights against a special account established in the name of another secured party. Exclusive control protects payment integrity by limiting credit foreclosures to accounts specifically designed as collateral; thus, it is less likely that payment settlement issues will be implicated. Exclusive control also protects the interests of involuntary creditors because it leaves general operating accounts available for garnishment purposes.

Limiting perfection to exclusive control also resolves the notice problems currently present in Revised Article 9. Revised Article 9 does not permit filed financing statements to perfect a security interest in deposit accounts, and it provides that banks have the right to refuse to disclose that they have entered a control agreement unless their depositor so requests.
Instead, Revised Article 9 notes that all existing and potential creditors are always on notice that banks maintaining the deposit account "may assert a claim against" them.209
Exclusive control readily places creditors on notice of conflicting interests upon learning

the nature of the account and grants priority to the named creditor consistent with the existing priority rule for creditors that establish accounts in their name.

This method of control functioned well under the common law.
Presumably, Revised Article 9's departure from the common law stemmed from uncertainty regarding how to establish control of deposit accounts.
While courts varied on what control mechanisms created an effective pledge, they uniformly agreed that the establishment of special accounts from which the depositor could not withdraw funds created an effective pledge in favor of the secured party.
Adding deposit account financing within the scope of Revised Article 9 resolves issues of uncertainty and likely will reduce the costs of establishing reserve accounts. Limiting financing to exclusive control through the establishment of special accounts resolves payment integrity and non-reliance lending issues, and promotes distributive efficiency as it relates to involuntary creditors.
Rules promoting deposit account financing through special accounts also promote allocative efficiency by enabling depositors to choose the creditor from which they desire to obtain financing, where the depositor's choice will be motivated by a desire to maximize his wealth and utility. The only question remaining is whether banks will cooperate with creditors seeking to establish special accounts for themselves.