

MAINE SUPREME JUDICIAL COURT RULES THAT CONTROL IS A CONDITION OF FORECLOSING ON A DEPOSIT ACCOUNT

In a disconcerting decision, the Supreme Judicial Court of Maine has cast significant doubt on the ability of a secured party to realize the value of a deposit account via a foreclosure sale when the secured party lacks control.

The Maine case: creditor forecloses unperfected security interest. The case, *Davis Forestry Products, Inc. v. DownEast Power Co.*, 2011 WL 82179 (Me. 2011), has relatively simple facts. In 2005, Prospect Capital Corp. made a loan to the debtor, Worcester Energy Corp., secured by a variety of real and personal property, including deposit accounts. Prospect took no steps to acquire control over Worcester Energy's deposit accounts, and therefore its security interest in the deposit accounts was unperfected.

In 2009, Worcester Energy defaulted and Prospect conducted a foreclosure sale by public auction of all the collateral, including Worcester Energy's deposit account at its bank, The First, N.A. Prospect was the high bidder. Prospect then executed a "Release Bill of Sale," conveying its interest in the deposit account to DownEast Power, its wholly owned subsidiary. Two weeks later, Forestry Products obtained a writ of attachment against the deposit account to enforce a default judgment against Worcester Energy. DownEast moved to dissolve the attachment, claiming it was the legal owner of the deposit account.

The court's analysis. The court began by observing that because DownEast's interest was derived from the "Release Bill of Sale," its claim to the deposit account necessarily depended upon what DownEast acquired from Prospect. DownEast argued that Prospect conducted a disposition of the deposit account under UCC § 9-610, which divested Worcester Energy of its ownership before Davis's interest as a lien creditor attached. Although the court acknowledged that nothing in Article 9 or its comments excludes deposit accounts from the scope of UCC § 9-610 or indicates that control is a prerequisite to a disposition, the court rejected this argument. To do this, the court drew implications from UCC § 9-607, which governs a secured party's direct collection rights on receivables.

Specifically, UCC §§ 9-607(a)(4) and (5) state that a secured party may apply the deposit account balance to the secured obligation, or instruct the depository bank to pay, if the security interest is perfected by control. If, however, the security interest is unperfected, or the funds in the deposit account are proceeds perfected by filing, Comment 7 indicates that the depository bank owes no obligation to obey

the secured creditor's instructions and "the secured party must use an available judicial procedure." Thus, according to the court, "unique rules apply to secured creditors seeking self-help remedies with regard to deposit accounts."

From this sound footing, the court lurched forward. It concluded that a secured creditor without control over the deposit account would be circumventing the limitations in UCC § 9-607 by exercising the disposition rights listed in UCC § 9-610. In reaching this conclusion, the court cited two commentators, both of whom indicated that a secured party without control will not be able to use self-help remedies. The court then treated DownEast as merely an assignee of Prospect's unperfected security interest, which took subject to Davis's judicial lien under UCC § 9-317(a).

In a disconcerting decision, the Supreme Judicial Court of Maine has cast significant doubt on the ability of a secured party to realize the value of a deposit account via a foreclosure sale when the secured party lacks control.

The court's error. The court confused **enforcement with priority**. The court confused the secured creditor's rights against the depository bank with the secured party's rights against third parties. Yet Article 9 carefully distinguishes between these two concepts in a variety of places. For example, UCC §§ 9-404(a) and 9-406(a) detail when a secured party has a right of enforcement against an account debtor. But priority in the account debtor's obligation — whether it be an account, chattel paper, or general intangible — is a completely different matter, governed by other provisions. *See, e.g.*, UCC §§ 9-322(a) and 9-330. Similarly, Article 9's anti-assignment rules sometimes allow a security interest to attach to a promissory note or general intangible while leaving the secured party with no ability to enforce the debtor's rights to that asset. *See* UCC § 9-408(d). Yet the secured party's inability to enforce against *the note maker or account debtor* has no bearing on whether the secured party may enforce its rights against *the debtor*, or whether the secured party has priority over the rights of another secured party or a lien creditor.

Indeed, the commentators the court cited were taken out of context. Professor (now Judge) Markell, one of the commentators quoted by the court, did write that Article 9 does not offer any self-help remedies to a secured party without control of the deposit account, but he was expressly referring to self-help remedies "to obtain the funds." Bruce A. Markell, *From Property to Contract and Back: An Examination of Deposit Accounts and Revised Article 9*, 74 CHI.-KENT L. REV. 963, 1005 (1999). Yes, to get the

depository bank to pay, the secured party needs control. But that says nothing about whether other self-help remedies — those that would not lead directly to payment of the funds, such as a disposition — are available.

Limited impact of the decision? Because the court based much of its analysis on whether Prospect had control, not on whether Prospect's security interest was perfected, one might question how the court would have ruled if Prospect's security interest attached to the deposit account as proceeds and thus was perfected without control under UCC § 9-315. Would the lien creditor still have won? The answer — fortunately — appears to be no. Recall that after concluding that the disposition did not divest the debtor of its interest in the deposit account, the court treated DownEast as an assignee of Prospect's security interest. The court then looked to Article 9's priority rules to conclude that the lien creditor won. If, however, the security interest were perfected prior to the disposition, it would remain perfected in the hands of the assignee, *see* § 9-310(c), and thus the assignee should have priority over a subsequent lien creditor, including a bankruptcy trustee. Therefore, the court's decision should have limited impact — provided other courts don't make the same mistake in confusing enforcement rights with priority.

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