RESEARCH MEMORANDUM

To: **Members of the URLTA Drafting Committee**

From: **Co-Reporters: Sheldon Kurtz and Alice Noble-Allgire**[1]

Date: **September 21, 2012**

Re: **Applicability of UCC Article 9 to residential lease security deposits**

This memorandum discusses the applicability of Article 9 of the Uniform Commercial Code (UCC) to tenant security deposits. Part I addresses the issue of whether a tenant security deposit falls within the purview of Article 9. Part II addresses some of the most relevant consequences if Article 9 does apply to tenant security deposits. Part III examines various state tenant security deposit statutes to see how they differ from what Article 9 requires in regards to tenant security deposits. The memorandum concludes by recommending revisions to the URLTA to clarify the rights and responsibilities of landlords and tenants concerning security deposits.

I. APPLICABILITY OF ARTICLE 9 OF THE UCC TO TENANT SECURITY DEPOSITS

The plain text of Article 9 would appear to govern security deposits in residential leases. As discussed below, however, the existing case law regarding leases in other contexts has created uncertainty about the issue.

Article 9 applies to any "transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract."[2] A "security interest" is defined as "an interest in personal property or fixtures which secures payment or performance of an obligation."[3] Under this broad language, the landlord has a security interest in the tenant's security deposit (personal property)[4] so long as the lease indicated that the purpose of the security deposit is to ensure that

[1] This memorandum was prepared in large part by Brian Lee, a research assistant to Professor Noble-Allgire.
[2] U.C.C. § 9-109(a)(1).
[3] *Id.* § 1-201(b)(35).
[4] *See* R. Wilson Freyermuth, *Are Security Deposits "Security Interests"? The Proper Scope of Article 9 and Statutory Interpretation in Consumer Class Actions*, 68 MO. L. REV. 71, 88-89 (2003) ("Both the text of Article 9 and its comments plainly contemplate that parties can create a security interest in money. This dictates a conclusion that if one party requires another party to deposit money in order to secure the depositor's payment or performance obligations to the depositee, then a security interest in money arises—unless Article 9's scope provisions explicitly exclude that transaction. Notably, Article 9's scope provisions contain no express exclusion for security deposits.").

the tenant upheld his obligations under the lease and would be returned to the tenant at the end of the lease if he or she did so. The parties need not identify the security deposit as a security interest in order for Article 9 to apply to the transaction.[5]

It should be noted, however, that Article 9 does not apply to "the creation or transfer of an interest in or lien on real property, including a lease or *rents* thereunder . . . ."[6] Therefore, Article 9 would not apply if a security deposit was, in effect, merely a prepayment of rent, such as in a two-year lease in which the tenant pays six months' rent in advance. The transaction does create a security interest in the deposit and Article 9 will apply, however, when the security deposit is a payment *additional* to rent and made to ensure that the tenant will pay rent and keep the premises in good condition during his or her tenancy.

Notwithstanding the plain language of the Act, courts have taken divergent views on whether security deposits can be classified as security interests under Article 9. In what appears to be the only reported opinion involving a security deposit for a lease of real property, an Ohio bankruptcy court relied upon the plain text of Article 9 to conclude that the Act covered a security deposit for a commercial lease.[7] The court found that the lease demonstrated an intent to create a security interest because the lease gave the landlord an interest in a certificate of deposit (CD) to secure the tenant's performance under the lease and the CD served as security and collateral for that performance. "The parties clearly intended [for the] property to secure the tenant's obligations, thus creating a security interest in that property."[8]

In cases involving leases in other contexts, however, courts have come out both ways on the issue. The Northern District of Illinois, for example, held that a security deposit given to secure a lessee's obligations under an automobile lease is a security interest under Wisconsin's Article 9 provisions.[9] Other courts have concluded, based upon the idea that the deposits were used to secure the performance of contractual rights, that lessors held security interests in security deposits pursuant to a lease for equipment[10] and for uninterrupted electrical service.[11]

Conversely, courts in at least eight jurisdictions[12] have held that security deposits given pursuant to leases for automobiles and other consumer goods are not security interests under

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[5] *See* U.C.C. § 9-109, cmt. 2 ("When a security interest is created, this Article applies regardless of the form of the transaction or the name that parties have given to it.").
[6] U.C.C. § 9-109(d)(11) (emphasis added).
[7] In re Verus Inv. Management, LLC, 344 B.R. 536, 542-43 (Bankr. N.D. Ohio 2006).
[8] *Id*. at 542.
[9] Demitropoulos v. Bank One Milwaukee, N.A., 953 F. Supp. 974, 980 (N.D. Ill. 1997).
[10] In re Atlanta Times, Inc., 259 F. Supp. 820, 827 (N.D. Ga. 1966).
[11] In re Barr, 180 B.R. 156, 160 (Bankr. N.D. Tex. 1995).
[12] Yeager v. General Motors Acceptance Corp., 719 So. 2d 210, 213 (Ala. 1998); Personal Financial Services, Inc. v. General Motors Acceptance Corp., 169 F. Supp. 2d 49, 54 (D. Conn. 2001); Knight v. Ford Motor Credit Corp., 735 N.E.2d 513, 517 (Ohio App. 2000); Spina v. Toyota Motor Credit Corp., 703 N.E.2d 484, 491 (1st Dist. 1998); Lawson v. Bank One, Lexington, N.A., 35 F. Supp. 2d 961, 964 (E.D. Ky. 1997); Rosen v. PRIMUS Auto. Fin. Servs, Inc., 618 N.W.2d 606, 608-09 (Minn. Ct. App. 2000); *In re* Ford Motor Credit Co. Motor

Article 9. In some cases, the courts have based this decision on the lack of language in the lease indicating that the parties intended to create a security interest.[13] In *Yeager v. General Motors Acceptance Corp.*, for example, the court found no intent to create a security interest when the lease referred to the security deposit as "part of the payment you make when you sign this Lease."[14] Instead, the *Yeager* court suggested that it would expect to see language similar to that in *General Electric Credit Corp. v. Alford & Associates, Inc.*,[15] where the lease explicitly stated that "[i]t is agreed that such reserves are to be held as security for and not in lieu of performance."[16] Another court, in coming to the same conclusion, merely held that the state legislature did not intend to apply the UCC provision regarding security interests to automobile lease security deposits.[17]

Other courts have focused on the nature of the security deposit transaction to conclude that Article 9 does not apply. More specifically, they have considered whether the state's common law characterizes security deposits as a "debt," a "pledge" or a "trust." A small number of courts, for example, treat security deposits as a pledge or trust, which imposes certain obligations upon the lessor to hold the property on the tenant's behalf and pay any interest the deposit earned to the lessee.[18] Article 9's baseline provisions are consistent with this view; as described below, the Act does not *require* the secured party to earn a return on the collateral, but its baseline rules provide that if the secured party does receive a monetary return, the secured party must apply that return to the debt or remit it to the debtor (unless the parties agree otherwise).[19] The majority of courts, however, have characterized security deposits as a debt – as an interest-free loan from the lessee to the lessor.[20] As such, the lessor is free to treat the funds as lessor's own (and is entitled to any interest the funds earn); the lessor has merely a contractual duty to repay the lessee if the lessee fully performed the lease obligations. Courts holding this view have declined to find security deposits to be security interests under Article 9 because "a conclusion to the contrary would derogate the common law principle that a security deposit instead creates only a debt."[21]

Vehicle Lease Litig., No. 95 CIV. 1876, 1998 WL 159051 at *4 (S.D.N.Y. Apr. 1, 1998); Doe v. GMAC, 635 N.W.2d 7, 12 (Wis. Ct. App. 2001).

[13] *Yeager*, 719 So. 2d at 213; *Personal Financial*, 169 F. Supp. 2d at 53.

[14] *Yeager*, 719 So. 2d at 213; *see also Personal Financial*, 169 F. Supp. 2d at 53.

[15] 374 So.2d 1316 (Ala.1979).

[16] *Yeager*, 719 So. 2d at 213 (citing *Alford & Assocs.*, 374 So. 2d at 1322).

[17] *Spina*, 703 N.E.2d at 491.

[18] In a trust, the lessor cannot commingle the security deposit with the lessor's own property and has a duty to invest the funds for the benefit of the lessee. *See, e.g.*, Donnelly v. Rosoff, 298 N.Y.S. 946, 948 (Mun. Ct. 1937). The law of pledges permits the lessor to commingle the funds with the lessor's own funds and had no duty to invest the deposit on the lessee's behalf, but any return the lessor did earn on the funds was considered property of the lessee. Ingram v. Pantages, 86 Cal. App. 41, 44-45, 260 P. 395, 396 (1927).

[19] U.C.C. § 9-207(c)(2).

[20] *See, e.g.*, *Lawson*, 35 F. Supp. 2d at 964; *Rosen*, 618 N.W.2d at 608-09; *In re Ford Motor Credit Co.*, 1998 WL 159051 at *4; *GMAC*, 635 N.W.2d at 12.

[21] *Knight*, 735 N.E.2d at 517; *see also Personal Financial*, 169 F. Supp. 2d at 54 (stating that the language of the lease – describing the security interest as a "payment" was consistent with "the

Recognizing the divergence of views, the Joint Editorial Board for Uniform Real Property Acts recommended addressing the issue in a revision to the URLTA. More specifically, the JEBURPA suggested that "revision of the URLTA would be useful to reinforce the correct view – firmly established in both the UCC and the [Uniform Consumer Leasing Act] – that a residential tenant security deposit creates an Article 9 security interest."[22] Although that view deviates from the traditional common law view, the JEBURPA's memo persuasively argued that security deposits fall within Article 9's broad scope provisions because the purpose of a security deposit is to secure a tenant's compliance with his obligations under the lease – which is the precise definition of a security interest.

Identifying security deposits as a security interest under Article 9, however, does not mean that the transaction must be governed by all of Article 9's provisions. To the contrary, Article 9's default provisions can be overridden by contrary lease provisions or other applicable statutes. Thus, the URLTA may provide different rules regarding the parties' rights and responsibilities with respect to security deposits in residential leases.[23]

In short, existing law creates uncertainty as to whether or not security deposits in residential leases are security interests covered by Article 9 of the UCC. Accordingly, the Drafting Committee should consider revising the URLTA to clarify the law by expressly affirming the applicability of Article 9 to security deposits under leases covered by URLTA or, conversely, establishing alternative rules that would effectively preempt Article 9's requirements. The extent to which the drafting committee pursues one path or another would likely depend upon its views of the desirability of applying Article 9's various rules to security deposits for residential leases, as discussed in the following section.

II. CONSEQUENCES IF TENANT SECURITY DEPOSITS ARE "SECURITY INTERESTS"

Article 9 provides certain baseline requirements for the handling of security deposits, both during the lease and after it has expired. Application of Article 9 also will affect who has a right to the deposit when either the landlord or tenant files for bankruptcy before the bankrupt party has performed all of its obligations under the lease.

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common-law principle that a security deposit creates only a debt") (quoting *Dolan v. Gen. Motors Acceptance Corp.*, 137 Ohio App.3d 668, 672, 739 N.E.2d 848 (Ohio Ct. App. 2000)..

[22] Memorandum from the JEBURPA to the ULC Committee on Scope and Program 6 (June 1, 2010).

[23] See U.C.C. § 9-109(c)(2) (This article does not apply to the extent that: . . . (2) another statute of this State expressly governs the creation, perfection, priority, or enforcement of a security interest created by this State or a governmental unit of this State . . . .").

A. Landlords' Responsibilities Concerning Security Deposits

1. *Safeguarding of security deposits*

The first question a landlord receiving a security deposit must consider is how to properly safeguard the deposit. Section 207 of Article 9 states that "if a secured party has possession of collateral . . . the secured party shall keep the collateral identifiable, but fungible collateral may be commingled . . . ."[24] In the context of security deposits paid to a landlord, this section of Article 9 would allow a landlord (the secured party) to commingle money obtained from security deposits (the collateral), but would not permit the landlord to commingle the deposits with the landlord's own personal funds unless permitted otherwise by the lease or another statute. Consistent with Article 9, the JEBURPA has recommended that the drafting committee consider revising the URLTA to follow the trend in which states have imposed an affirmative requirement upon landlords to hold security deposits in an account that is segregated from the landlord's property (but permit commingling of security deposits from multiple tenants).

2. *Return of security deposit and interest*

Upon termination of the lease, the landlord would have a duty under Article 9 to return the deposit or apply it to the tenant's outstanding obligations. Section 9-208 provides that when there is no outstanding secured obligation, "a secured party having control of a deposit account . . . shall: (A) pay the debtor the balance on deposit in the deposit account; or (B) transfer the balance on deposit into a deposit account in the debtor's name" within 10 days after receiving an authenticated (signed) demand from the debtor.[25]

To the extent that secured obligations are unfulfilled, Section 9-607 provides that a secured party "may take any proceeds to which the secured party is entitled . . . ."[26] If the secured party holds a security interest in a deposit account, the secured party "may apply the balance of the deposit account to the obligation secured by the deposit account."[27] These provisions would seem to allow a landlord to use a security deposit for its intended purpose, even absent express language to that effect in the lease.

Section 9-207(c) addresses the issue of interest or profits earned on collateral. Section 9-207(c)(2) provides that "a secured party having possession of collateral or control of collateral . . . shall apply money or funds received from the collateral to reduce the secured obligation, unless remitted to the debtor."[28] Notably, this provision would not impose an affirmative duty upon the landlord to place the security deposit in an interest-bearing account or otherwise invest it. The

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[24] *Id.* § 9-207(b)(3).
[25] *Id.* § 9-208(b)(2).
[26] *Id.* § 9-607(a)(2).
[27] *Id.* § 9-607(a)(4).
[28] *Id.* § 9-207(c)(2); *see also id.* § 9-207(c)(1) (providing that the secured party "may hold as additional security any proceeds, *except money or funds*, received from the collateral) (emphasis added).

provision would, however, require a landlord to pay any interest earned on a tenant's security deposit to the tenant.

B. Creditors' Rights in Security Deposits in the Event of Bankruptcy

1. *Landlords' rights against tenants' creditors*

If a landlord's security interest has attached and been perfected as described in further detail below, the landlord's rights in the security deposit would take priority over other creditors of the tenant in a bankruptcy action, including the bankruptcy trustee. In one bankruptcy case, for example, the court held that a bank held an enforceable, perfected security interest in a certificate of deposit that served as a security deposit under a lease, thereby making the assignee bank a secured, rather than an unsecured, creditor.[29] In another bankruptcy case, a landlord held a perfected security interest in a security deposit paid by the debtor pursuant to a commercial lease, giving the landlord rights to the security deposit as against government liens.[30]

Conversely, if a landlord's security interest is not perfected, the tenant's bankruptcy trustee can invalidate the landlord's security interest and recover the funds for the benefit of the tenant's bankruptcy estate. Thus, the claim of a landlord with an unperfected security interest is subordinate to the claim of another creditor with a perfected security interest, even if the latter creditor had actual knowledge of the landlord's interest.[31]

2. *Tenants' rights in landlords' bankruptcies*

If it is the landlord that declares bankruptcy, the law is a bit murkier regarding the rights of the various parties. An initial question, which has been litigated in a handful of cases, is whether the landlord may obtain a discharge in bankruptcy from the duty to repay a security deposit. The courts' resolution of that question has turned largely upon the nature of the landlord's interest in security deposits under state law.

Section 523(a)(4) of the Bankruptcy Code provides that a debtor is not discharged from any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny."[32] Accordingly, the courts have recognized that if a landlord is holding security deposits in a fiduciary capacity as a matter of state law, the landlord's duty to repay the deposits is not discharged in the bankruptcy proceeding.[33] Conversely, the landlord may be entitled to a discharge if the security deposit creates only a debtor-creditor relationship.[34]

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[29] In re Verus Inv. Mgmt., LLC, 344 B.R. 536, 546 (Bankr. N.D. Ohio 2006).
[30] United States v. Samel Refining Corp., 461 F.2d 941, 943 (3d Cir. 1972).
[31] Lone Oak Farm Corp. v. Riverside Fertilizer Co., 428 N.W.2d 175, 180 (Neb. 1988).
[32] 11 U.S.C. 523 (a)(4).
[33] In re McGee, 353 F.3d 537, 540-41 (7th Cir. 2003); In re Frempong, 460 B.R.189, 195 (Bankr. N.D. Ill. 2011).
[34] In re Paeplow, 217 B.R. 705, 710 (Bankr. D. Vt. 1998).

In *In re Paeplow*, a bankruptcy court concluded that Vermont's law governing security deposits "is more consistent with a debtor-creditor relationship than with a trust."[35] The court noted that the Vermont statute does not require landlords to segregate security deposits in a separate, interest bearing account and that landlord are free to use security deposits as the landlord wishes. "[W]hen the 'trustee' of the funds is entitled to use them as his or her own and commingle them with his or her own money, a debtor creditor relationship exists, not a trust."[36] The court, therefore, rejected the tenants' claim that the landlord's liability to them for return of their security deposit was non-dischargeable under section 523(a)(4).

Conversely, in *In re McGee*, a federal appellate court concluded that the security deposit requirements of Chicago's municipal code created a "trust-like relation between landlord and tenant, the sort of relation that federal law labels 'fiduciary.'"[37] As an initial matter, although the ordinance expressly stated that the funds shall not be subject to the claims of any creditor of the landlord, the court did not find that provision dispositive because "[f]ederal law preempts any effort by state and local governments to determine which assets may be reached, for what purposes, by particular creditors."[38] Instead, the court focused on three requirements for how the security deposits must be handled: (1) the money must be deposited in an insured account in a financial institution; (2) the funds remain the tenant's property while on deposit; and (3) every tenant's deposit must not be commingled with other assets.

> Segregation of funds, management by financial intermediaries, and recognition that the entity in control of the assets has at most "bare" legal title to them, are hallmarks of the trust. These real attributes, not the labels applied by the ordinance, bring into play a fiduciary obligation and thus § 523(a)(4). . . . The ordinance charges landlords with duties to be carried out on behalf of tenants, to protect their entitlement to return of deposits with interest if they keep their part of the bargains.[39]

Because the landlord failed to comply with her responsibilities for safekeeping the security deposit, the court concluded that her defalcation disqualified her from receiving a discharge.

A related question is whether – or to what extent – security deposits would become part of a landlord's bankruptcy estate in the first place. Here again, the resolution of the question is murky and may depend upon the nature of the security deposit transaction under state law. In what appears to be the only decision to even touch on the issue, a federal district court recognized that under the Chicago municipal code, tenant security deposits "are held 'in trust' by the landlord and thus are not part of the Bankruptcy Estate of any landlord in a Bankruptcy filing."[40] The court's assertion that security deposits are not part of the bankruptcy estate was dictum and unsupported by citation. There is general support in the case law, however, for the

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[35] *Id.*
[36] *Id.* (quoting In re Shervin, 112. B.R. 724, 734 (Bankr. E.D. Pa. 1990)).
[37] In re McGee, 353 F.3d 537, 540-41 (7th Cir. 2003).
[38] *Id.* at 540.
[39] *Id.*at 540-41.
[40] *Frempong*, 460 B.R. at 195.

proposition that Bankruptcy Code section 451(d)[41] would exclude from the bankruptcy estate any property that the debtor holds as a trustee.[42]

A slightly different result might occur if security deposits are categorized as security interests under state law. In that situation, as one bankruptcy treatise asserts, "the estate acquires that security interest and the right to enforce that security interest but not the property subject to that security interest."[43] The treatise supports this assertion with the general view that "the estate is not intended to expand the debtor's rights beyond those that exist prior to commencement."[44] It also finds reinforcement for the notion in Bankruptcy Code section 541(d), which states that if debtor has only legal title, just the legal title becomes part of the estate. Under this view, the bankruptcy trustee would obtain the security interest as part of the bankruptcy estate but the trustee is still bound to return the security deposit to the tenant upon fulfillment of the lease's obligations. By contrast, if the security deposit transaction creates only a debtor-creditor relationship, courts would likely find that the property becomes part of the landlord's bankruptcy estate and the tenant would be treated as an unsecured creditor of the estate.

3. *Attachment and perfection of security deposits*

Attachment and perfection are critical to enforcement of a security interest. While this process may be somewhat complicated for some types of collateral, it would be relatively straightforward for security deposits in residential leases. Indeed, the requirements would be satisfied simply by the actions that most landlords routinely follow in handling security deposits.

Attachment occurs when a security interest becomes enforceable against the debtor.[45] This attachment occurs only if "value has been given; . . . the debtor has rights in the collateral; and . . . the debtor has authenticated a security agreement that provides a description of the collateral . . . ."[46] Value is "any consideration sufficient to support a simple contract"[47] and a person can authenticate something merely by signing it.[48] Therefore, a signed lease providing for a security deposit will almost always be enough to attach the landlord's security interest in the money or check comprising the security deposit because the tenant will gain access to the premises (the value) and will still have an interest in the security deposit to the extent that he is entitled to its return if he fulfills all obligations under the lease.

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[41] 11 U.S.C. § 541(d) ("Property in which the debtor holds, as of commencement of the case, only legal title and not an equitable interest . . . becomes property of the estate . . . only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.")

[42] *See Begier v. I.R.S.*, 496 U.S. 53, 59, 110 S.Ct. 2258, 110 L.Ed.2d 46 (1990) ("Because the debtor does not own an equitable interest in property he holds in trust for another, that interest is not 'property of the estate.'").

[43] 6 West's Fed. Admin. Prac. § 7032 (3d ed.).

[44] *Id.*

[45] *Id.* § 9-203(a).

[46] *Id.* § 9-203(b)(1)-(3)(A).

[47] *Id.* § 1-204(4) (2003).

[48] *Id.* § 9-102(7)(A).

For a security interest to become enforceable against a third party, however, it must also be perfected, which (at the risk of oversimplification) means that the secured party has taken the necessary steps to provide notice of its security interest.[49] Although filing a financing statement is generally required to perfect a security interest in other types of collateral,[50] this requirement does not apply to "collateral in the secured party's possession"[51] or "deposit accounts,"[52] which would include a checking or savings account.[53] Instead, a secured party must take possession of money in order to perfect a security interest in it,[54] and can also perfect a security interest in an instrument, such as a check, by taking possession of it.[55] This means that a landlord can perfect his security interest in cash or a check constituting a tenant security deposit by safeguarding it in a safe deposit box (or hiding it under a mattress, for that matter).

However, most landlords presumably place money or checks they receive as security deposits into a bank account. This poses additional requirements for attachment and perfection. Attachment is not much of a problem, since "a security interest attaches to any identifiable proceeds of collateral," which would include cash or a check deposited into a bank account.[56] For commingled money in a bank account to be "identifiable," the balance of the account must simply stay above the amount of the security deposit.[57] As for perfection, a security interest in proceeds remains perfected, so long as the security interest in the collateral was perfected, if "the proceeds are identifiable cash proceeds,"[58] which include money, checks, and deposit accounts.[59] In short, if a landlord has a perfected interest in cash or a check received as a security deposit and places that cash or check in a savings or checking account, the landlord's security interest in the money in that account is attached and perfected so long as the balance of the account continuously stays above the amount of the security deposit.

III. PROVISIONS OF EXISTING STATE TENANT SECURITY DEPOSIT STATUTES

A previous memorandum prepared for the drafting committee discussed the wide variation in state treatment of security deposits and will not be discussed in detail here. Instead, the following discussion is intended to provide a brief summary of the ways that states have paralleled or deviated from Article 9. As indicated above, Article 9's baseline rules apply only in the absence of contrary law or agreement of the parties; thus adoption of contrary rules in the

[49] *Id.* § 9-308(a) ("a security interest is perfected if it has attached and all of the applicable requirements for perfection . . . have been satisfied")
[50] *Id.* § 9-310(a).
[51] *Id.* § 9-310(b)(6).
[52] *Id.* § 9-310(b)(8).
[53] *Id.* § 9-102(a)(29).
[54] *Id.* § 9-312(b)(3).
[55] *Id.* § 9-313(a).
[56] *Id.* § 9-315(a)(2).
[57] *Id.* § 9-315(b)(2).
[58] *Id.* § 9-315(d)(2).
[59] *Id.* § 9-102(a)(9).

URLTA (like some of those discussed below) would effectively preempt Article 9's baseline rules.

A. Characterization of Security Deposits as Security Interests

Connecticut appears to be the only state that has enacted legislation expressly identifying a security deposit in a residential lease as a security interest.[60] A few states have enacted statutes that stop short of labeling the deposit a security interest, but that explicitly state that a landlord holds the deposit "for" the tenant and that the tenant's claim against the deposit has priority over the claims of the landlord's creditors (which accomplishes a functionally similar result).[61] Statutes in Connecticut, Michigan, and Massachusetts explicitly state that the deposit remains the tenant's property.[62] Including a provision like this in the revised URLTA would clarify that security deposits generally should to be treated as a security interest, rather than simply a "debt."

B. Statutes Concerning Landlords' Handling of Security Deposits

Consistent with Article 9, ten states and the District of Columbia have enacted statutes that would prohibit landlords from commingling tenant security deposits with the landlord's own money.[63] Eighteen states with security deposit statutes, however, have no such prohibition.[64]

In addition, although Article 9 would not require secured parties to place security deposits in interest-bearing accounts or pay interest on them unless interest had actually been earned,[65] a few states have enacted statutes to the contrary. Five states and the District of Columbia expressly require landlords to place security deposits in interest-bearing accounts.[66] Twenty-three states do not expressly impose this requirement on landlords,[67] but several of these twenty-three states have enacted statutes obligating landlords to hold security deposits in "trust" for their tenants.[68] Whether these statutes would require that security deposits be placed in interest-bearing accounts is unclear.

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[60] CONN. GEN. STAT. § 47a-21 ("Any security deposit paid by a tenant shall remain the property of such tenant in which the landlord and his successor shall have a security interest … to secure such tenant's obligations.").

[61] CAL. CIV. CODE § 1950.5; HAW. REV. STAT. § 521-44; IOWA CODE § 562A.12(2); ME. REV. STAT. tit. 14, § 6038; MD. REAL PROP. CODE § 8-203; MINN. STAT. ANN. § 504B.178; MISS. CODE § 89-8-21; ORE. REV. STAT. § 90.300; TEX. PROP. CODE § 92.103(c).

[62] CONN. GEN. STAT. § 47a-21; MASS. GEN. LAWS tit. 186, § 15B; MICH. COMP. LAWS § 554.605.

[63] *See, e.g.*, MD. CODE, REAL PROP. § 8-203; MASS. GEN. LAWS ch. 186, §15B.

[64] *See, e.g.*, MINN. STAT. § 504B.178; MISS. CODE § 89-8-21.

[65] *See* U.C.C. § 9-207(c)(2).

[66] *See, e.g.*, MD. CODE, REAL PROP. § 8-203; MASS. GEN. LAWS ch. 186, §15B.

[67] *See, e.g.*, MINN. STAT. § 504B.178; MISS. CODE § 89-8-21.

[68] *See, e.g.*, GA. CODE § 44-7-31; S.C. CODE § 27-40-410.

Nearly half of the states are silent on the issue of safeguarding security deposits. Wyoming does not have a statute dealing with tenant security deposits, and twenty-one other states have no statutes stating as to how security deposits must be held by landlords.[69]

C. Statutes Concerning Payment of Interest on Security Deposits

As to the issue of when landlords must pay tenants interest on their security deposits, thirty-one states have no statute that speaks to the matter.[70] In contrast, thirteen states and the District of Columbia require that interest be paid to tenants,[71] four states merely allow for interest to be paid to tenants under certain circumstances, such as when the security deposit is placed in an interest-bearing account,[72] and Oklahoma always allows landlords to keep any interest they earn on security deposits.[73] As to the amount of interest that must be paid to a tenant on a security deposit, six states, consistent with Article 9, require the landlord to pay the actual interest received.[74] However, seven states and the District of Columbia require the landlord to pay based on a set interest rate,[75] and four states determine the amount to be paid on various factors.[76]

Some states have prerequisites before interest is to be paid by landlords on security deposits or allow a certain amount of interest to be retained by the landlord. Six states require interest to be paid to a tenant only if the tenant's lease term or occupancy is longer than a specified period.[77] Similarly, Iowa and Pennsylvania only require landlords to pay tenants interest that accrues past a certain point in time.[78] Maryland, New Mexico, and Ohio have statutes stating that tenants are only entitled to interest if the security deposit is over a certain amount.[79] New York and Pennsylvania allow a landlord to retain interest in the amount of an annual one-percent administrative fee.[80] Illinois and New York only require landlords to pay interest to tenants on security deposits if they own property containing a certain number of

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[69] *See, e.g.*, ARIZ. REV. STAT. § 33-1321; IDAHO CODE § 6-321.
[70] *See, e.g.*, N.C. GEN. STAT. § 42-52; S.C. CODE § 27-40-410.
[71] *See, e.g.*, CONN. GEN. STAT. § 47a-21; N.D. CENT. CODE § 47-16-07.1.
[72] *See, e.g.*, FLA. STAT. § 83.49; N.Y. GEN. OBLIG. LAW § 7-103 (New York, however, does make interest paid to tenants mandatory if the security deposit is for property containing six or more units).
[73] *See* OKLA. STAT. tit. 41, § 115.
[74] *See, e.g.*, N.Y. GEN. OBLIG. LAW § 7-103; N.D. CENT. CODE § 47-16-07.1.
[75] *See, e.g.*, MINN. STAT. § 504B.178; OHIO REV. STAT. § 5321.16.
[76] *See, e.g.*, FLA. STAT. § 83.49 (landlord elects between rate of 5% or 75% of interest collected); VT. STAT. tit. 9, § 4461 (amount of interest to be determined by town or municipality).
[77] *See, e.g.*, N.M. STAT. § 47-8-18 (lease term of one year or more); N.D. CENT. CODE § 47-16-07.1 (occupancy for nine months or more).
[78] *See* IOWA CODE § 562A.12 (five years); 68 PA. STAT. § 250.511b (two years).
[79] *See* MD. CODE, REAL PROP. § 8-203 (deposits over fifty dollars); N.M. STAT. § 47-8-18 (deposits greater than one month's rent); OHIO REV. STAT. § 5321.16 (deposits greater than one month's rent or fifty dollars, whichever is greater).
[80] *See* N.Y. GEN. OBLIG. LAW § 7-103; 68 PA. STAT. § 250.511b.

units.[81] Finally, Connecticut allows a landlord to keep the monthly interest if the tenant is more than ten days late with his or her rent payment, provided the lease does not impose another penalty on the late payment.[82]

CONCLUSION AND RECOMMENDATION

There is currently uncertainty in the courts as to whether Article 9 applies to security deposits in residential leases. Although the broad language of Article 9 suggests that security deposits do fall within the act's scope, some courts have been reluctant to interpret the act in that way because of the burden it would impose upon lessors to comply with some of Article 9's baseline requirements. Because the courts are divided on the issue, it would be helpful for the revised URLTA to clarify that security deposits are in fact security interests. This position would be helpful to both parties by protecting security deposits from creditors.

Recognizing security deposits as security interests, however, does not require that security deposits comply with all of the baseline provisions in Article 9. To the contrary, Article 9 may be preempted by contrary agreement of the parties or other positive law. Thus, to the extent the drafting committee concludes that any of Article 9's baseline requirements are inappropriate in the landlord-tenant context, the committee should consider adoption of different requirements in the URLTA. The drafting committee already started down that path with its discussion of security deposits at the March 2012 meeting.

[81] *See* 765 ILCS § 715/1 (twenty-five or more); N.Y. GEN. OBLIG. LAW § 7-103 (six or more).
[82] *See* CONN. GEN. STAT. § 47a-21.