



Colorado Senate Judiciary Committee
Old Supreme Court
Colorado State Capitol
200 East Colfax Avenue
Denver, CO 80203-1784

April 17, 2024

Dear Chair Gonzales, Vice Chair Roberts, Senator Gardner, Senator Van Winkle, and Members of the Colorado Senate Judiciary Committee,

Thank you for the opportunity to testify in support of House Bill 1232, which adopts the Uniform Special Deposits Act. A copy of the Act, as well as other supporting materials can be found on the Uniform Law Commission's website www.uniformlaws.org.

The Uniform Law Commission (ULC) is a state-supported organization that was established in 1892 and provides states with non-partisan, well-conceived and well-drafted legislation that brings clarity and stability to critical areas of state statutory law.

ULC commissioners must be lawyers, qualified to practice law. They are practicing lawyers, judges, legislators and legislative staff, and law professors, who have been appointed by state governments as well as the District of Columbia, Puerto Rico and the U.S. Virgin Islands. ULC commissioners donate thousands of hours of legal work, without compensation, to research, draft and promote enactment of uniform state laws in areas of state law where uniformity is desirable and practical.

The Uniform Special Deposits Act (the "Act"), as adopted by House Bill 1232, is the result of a multiyear, collaborative drafting process with input from leading experts in commercial law and the financial services industry. The Act provides clarity to an area of law that has been uncertain for a number of years.

Special deposits are banking products that have different characteristics than other deposit accounts like checking or savings deposits. Special deposits are established for a particular purpose, and a beneficiary's entitlement to payment is determined only after a contingency has occurred. That contingency could be the closing of a sale of real estate, the distribution of funds to class members after the court approves of the settlement of a class action, or the distribution of a commercial tenant's security deposit when the leasehold ends. These deposits ensure funds will be available to the person entitled to them in the future.

Special deposits serve an important function in commerce and industry. They are safe, secure, and efficient. Safety and security are provided by a regulated bank, banking regulation



(including the regulators), and perhaps deposit insurance. Efficiency is provided by the simplicity of the deposit account mechanism, its relatively low cost, and the fact that banks typically provide a return on the principal balance of deposits in the form of interest. Parties using a special deposit expect that, when the contingency occurs, the money will be there to pay.

While they are a vital component of our banking infrastructure, legal uncertainties have caused many to avoid using special deposits. These uncertainties thwart the parties' expectations that funds in a special deposit will be available to them once the contingency has occurred. Historically courts have attempted to fashion protections through, among other measures, common law referring to special deposits. Case law has analogized special deposits to a trust, bailment, or custody arrangement. However, these characterizations are anachronistic in the context of modern banking and do not reflect how the special deposit is used in practice. The attributes that make a deposit "special," that is, the rights of the parties interested in the special deposit, are also uncertain under current law.

The key objectives of House Bill 1232 are to: (1) preserve and protect the important functionality of the special deposit by eliminating the legal uncertainties that inhibit use; (2) honor the expectations of the parties; (3) build on existing law applicable to general deposits in the 50 states; (4) disrupt existing law as little as possible; and (5) deliver narrowly-tailored solutions to cure four problems that can frustrate the expectations of parties electing to use a special deposit.

These are the areas where the common law needs to be improved:

Identification of the Special Deposit

The Act clarifies the defining characteristics of a special, as opposed to general, deposit. Under the Act, a special deposit must be (i) designated as "special" in an account agreement governing the deposit at a bank, (ii) for the benefit of at least two beneficiaries, (iii) denominated in money, (iv) for a permissible purpose identified in the account agreement, and (v) subject to a contingency specified in the account agreement that is not certain to occur, but if it does occur, creates the bank's obligation to pay a beneficiary. If all those characteristics are present, the deposit is a special deposit.

The requirement that the special deposit serve a permissible purpose is a crucial feature of the Act. It prevents the special deposit from being used inappropriately for fraudulent or abusive purposes—for example, to hinder or defraud creditors. A permissible purpose is defined as "a governmental, regulatory, commercial, charitable, or testamentary objective of the parties stated in the account agreement." A special deposit must serve a permissible purpose from creation until termination. If the special deposit ceases to serve such a purpose before termination, the protections of the Act will not apply to any future funds deposited in the



account. In addition, the Act ensures that a deposit or transfer voidable under other law is not protected by designating it as a special deposit.

Bankruptcy of the Depositor

The Act also clarifies the treatment of a special deposit in the event of a depositor's bankruptcy. Under the law of many states, a depositor will retain rights to a special deposit until the determination of a contingency that resolves ownership of the deposited funds. Thus, a special deposit could be "swept" into the bankruptcy estate of the person who deposited them.

For example, imagine a commercial office building where the landlord requires tenants to pre-pay rent as a security deposit. The landlord may put each tenant's security deposit into a single, commingled account. If there is no damage to the property at the end of the lease, the security deposit is due to the tenant. If the landlord declares bankruptcy, the tenant's security deposit could be caught up in the bankruptcy proceeding. The Act will prevent this outcome and ensure funds remain available for the tenant.

Premature Creditor Process

Third, the Act provides certainty about the applicability of creditor process on a special deposit. Under current law, there is considerable uncertainty as to whether a creditor of a debtor who is a potential payee from a special deposit may either attach the special deposit or reach the special deposit with a temporary restraining order or injunction. After all, the identity of the ultimate beneficiary has not been determined at the time the special deposit is established because the contingency has not yet occurred. Creditor process can therefore "freeze" a special deposit and interfere with the intended purpose.

Section 11-111-109 provides that creditor process is not enforceable against the bank holding the special deposit, except in limited circumstances. It may be enforceable against the bank holding a special deposit with respect to any amount that it must pay to a beneficiary after determination of the contingency, but the special deposit itself is fully protected. Section 11-111-110 eliminates the ability of creditors to use an injunction or temporary restraining order to achieve the same or a similar outcome.

Bank Setoffs

The Act also addresses whether the bank holding the special deposit can exercise a right of set off or recoupment that is unrelated to any payment to a beneficiary or to the special deposit itself. Section 11-111-111 provides that a bank may not use special deposits to satisfy unrelated debts. There are certain exceptions dealing with fees associated with the special deposit, and situations where an accounting offset is needed to remedy a mistaken credit to the special deposit



account. However, the general rule is clear — there is no threat from recoupment or setoff, and the special deposit is protected.

Self-Imposed Limitations of the Uniform Special Deposits Act

The Act contains several self-imposed limitations. Importantly, the Act was drafted with a “minimalist” philosophy and addresses only specific uncertainties existing under current law. The Act does not duplicate the law governing deposits generally and, instead, alleviates the problems in existing law that cause uncertainty around special deposits. This enables the Act to operate in conjunction with existing commercial law and embraces the parties’ freedom to contract.

Another important limitation of the Act is its “opt-in” nature. The bank and its customer must elect to treat the deposit as a special deposit to be covered by the Uniform Special Deposits Act. This permits existing relationships to continue undisturbed. Parties can also amend existing agreements to be covered by the Act if the relationship satisfies the Act’s criteria to establish a special deposit.

Additionally, the Act does not address the insolvency of the bank holding a special deposit, for two reasons. First, bank insolvency law regarding special deposits is clear and well-developed. Second, bank insolvency law has largely become the product of federal law. State law, including the Act, can only perform a limited role.

Finally, the Act does not require banks to offer a special deposit product. Some banks may decide that this will not be among their offered suite of products or that they will offer such a product under limited circumstances.

Conclusion

The Uniform Special Deposits Act is intended not to introduce new legal concepts, but rather to eliminate uncertainty that attaches to the use of special deposits under existing law and therefore help ensure that the expectations of parties entering into those transactions are met.

Those are just a few benefits offered by the Uniform Special Deposit Act. I thank you for your time, and respectfully urge the Committee to report favorably on House Bill 1232.

Sincerely,

A handwritten signature in black ink, appearing to read 'Kari E. Bearman'.

Kari Bearman
Legislative Counsel, Uniform Law Commission

Section By Section Summary of the Uniform Special Deposits Act as adopted by Colorado House Bill 1232 of 2024

Section 11-111-101. Title

States the short title of the legislation.

Section 11-111-102. Definitions

Contains the key terms used throughout the act including: “account agreement,” “bank,” “beneficiary,” “depositor,” “knowledge,” and “permissible purpose.”

Section 11-111-103. Scope; Choice of Law; Forum

Sets forth the scope of the Act. The Act applies to a special deposit where the account agreement states the intent of the parties to establish a special deposit. The Act is an opt-in statute; parties to the account agreement must affirmatively decide to apply its protections. Parties can select to be governed by the laws of any state that has enacted the Act, even without any relation between such state and the parties, the forum state, special deposit or any related transaction. Parties have the same flexibility in choice of forum for the resolution of disputes.

Section 11-111-104. Variation by Agreement or Amendment

Sets forth which sections of the act may be varied by agreement and which sections may not be varied by agreement.

May be Amended in the Account Agreement:

- Section 11-111-107. Payment to Beneficiary by Bank
- Section 11-111-112. the Duties and Liability of Bank
- Section 11-111-113. the Term and Termination of a special deposit

May Not Be Amended in the Account Agreement (with limited exceptions):

- Section 11-111-102. Definitions
- Section 11-111-103. Choice of Law, Scope, and Forum
- Section 11-111-104. Variation by Agreement or Amendment
- Section 11-111-105. Requirements for Special Deposits
- Section 11-111-106. Permissible Purpose
- Section 11-111-108. Property Interest of Depositor or Beneficiary
- Section 11-111-109. When Creditor Process is Enforceable Against Bank
- Section 11-111-110. Injunction or Similar Relief
- Section 11-111-111. Recoupment or Set Off
- Section 11-111-114. Principles of Law and Equity

Section 11-111-105. Requirements for Special Deposit

Sets forth the requirements for a special deposit. In order for a deposit to be a special deposit, the deposit must be: (1) designated as “special” in the account agreement governing the deposit at the bank; (2) for the benefit of at least two beneficiaries (one or more of which may be a

depositor); (3) denominated in money; (4) for a permissible purpose; and (5) subject to a contingency that is not certain to occur, but if it does occur, creates the bank's obligation to pay a beneficiary.

Section 11-111-106. Permissible Purpose

States that a special deposit must serve at least one permissible purpose stated in the account agreement from the time the special deposit is created until it is terminated. If the bank or a court determines that the special deposit no longer serves a permissible purpose before the termination of the special deposit, the protections of the Act cease to apply to the special deposit and the bank may take actions it believes necessary, including terminating the special deposit.

Section 11-111-107. Payment to Beneficiary by Bank *(May be amended by agreement)*

Provides that a bank is obligated to pay a beneficiary (unless stated otherwise) if there are sufficient funds in the balance of the special deposit. The bank's debt to the beneficiary accrues when a bank is obligated to pay a beneficiary (i.e., when the contingency has been determined and the bank has knowledge of the determination). A bank is not obligated to pay a beneficiary if there are not sufficient funds in the special deposit account.

Provides a default rule that when funds in a special deposit are insufficient to pay a beneficiary in full, the beneficiary may elect to receive the available funds and that payment discharges the bank's obligation to pay the beneficiary. The obligation is immediately due and payable unless the account agreement provides otherwise.

Section 11-111-108. Property Interest of Depositor or Beneficiary

Contains one of the key protective provisions of the Act that makes the special deposit "bankruptcy remote" from the depositor. Neither a depositor nor a beneficiary has a property interest in a special deposit before the outcome of the contingency is determined. Any property interest is the right to receive future payment once the bank becomes obligated to pay a beneficiary and not a right to the special deposit itself.

Section 11-111-109. When Creditor Process Enforceable Against Bank

This provision protects the special deposit from creditor process that might cause the bank holding the special deposit to "freeze" all or part of the special deposit, which would disable the special deposit from performing its permissible purpose. Creditor process is only enforceable if process is served on the bank and provides sufficient information to identify the depositor or beneficiary, and the bank has reasonable opportunity to act on the process.

Section 11-111-110. Injunction or Similar Relief

Prevents creditors and other parties from seeking a temporary restraining order or preliminary injunction against a bank holding a special deposit. This section avoids that result and creates a safeguard for situations involving potential fraud that is modeled after Section 5-109(b) of the Uniform Commercial Code.

Section 11-111-111. Recoupment or Set Off

Establishes that a bank may not exercise a right of recoupment or set off against a special deposit, with limited exceptions, including for unpaid fees with respect to a special deposit or when a bank needs to remedy a mistaken credit.

Section 11-111-112. Duties and Liability of Bank *(May be amended by agreement)*

Clarifies that a bank does not have a fiduciary duty to any person with respect to the special deposit. A debtor-creditor relationship is established between the bank and its customer. The ultimate obligation of a bank holding a special deposit will be due to a beneficiary (which could be a depositor) once the occurrence of a contingency is determined.

Also codifies current commercial practice where the bank holding the special deposit will rely upon a record, if it, rather than a third party, is to determine the contingency. A bank does not have a duty under the Uniform Special Deposits Act to make such a determination, but it may be required under other law to make such a determination (for example, to determine under federal or state anti-money laundering law if a special deposit violates prohibitions against money laundering), or it may be required to act because another person has made such a determination under other law, including a court of competent jurisdiction.

Section 11-111-113. Term and Termination *(May be amended by agreement)*

Provides default rules. In the event the account agreement does not provide a termination provision, a special deposit terminates five years after the date the special deposit was first funded. Also contains a right of remission.

Section 11-111-114. Principles of Law and Equity

Specifies that the Uniform Special Deposits Act is supplemented by current law (UCC, consumer protection law, law governing deposits generally, law related to escheat and abandoned or unclaimed property) except to the extent those laws are inconsistent with this act.

Section 11-111-115. Uniformity of Application and Construction

Contains the standard section in all uniform acts providing that courts must construe the chapter to promote uniformity among the enacting states.

Section 11-111-116. Transitional Provision

Provides that this Act applies to a special deposit made under an account agreement executed on or after the effective date.



THE UNIFORM SPECIAL DEPOSITS ACT (2024)

- A Summary -

The Uniform Law Commission drafted the Uniform Special Deposits Act (the “Act”) to provide clarity on an area of law that has been subject to uncertainty for many years. A special deposit is a deposit of money at a bank created for a particular purpose where the person entitled to the money is only determined after a specified event or contingency occurs.

Special deposits play an important role in commerce and industry, but their use has been diminished because of legal uncertainties. Various state laws improperly characterize special deposits as something akin to a trust, bailment, or agency – which do not accurately describe how special deposits are used in practice. Existing case law creates even more confusion because it refers to bank practices that are no longer followed.

The Act establishes a framework for banks and their customers to utilize special deposits with greater certainty of how such deposits will be treated under various circumstances. Importantly, the Act is an “opt in” statute. Banks and their customers must specify in their account agreement that they intend to be covered by the Uniform Special Deposits Act as enacted in a particular state. This feature permits existing relationships to continue undisturbed, and lets parties choose to utilize the protections provided by the Act when they wish. Matters not addressed by the Act are controlled by general laws already governing deposits or contractual arrangements.

The Act remedies four key legal uncertainties. First, the Act clarifies what a “special deposit” is. It establishes clear criteria for a deposit to be considered “special” under the Act. A special deposit must be (i) designated as “special” in an account agreement governing the deposit at a bank, (ii) for the benefit of at least two beneficiaries (one or more of which may be a depositor), (iii) denominated in money, (iv) for a permissible purpose identified in the account agreement, and (v) subject to a contingency specified in the account agreement that is not certain to occur, but if it does occur, creates the bank’s obligation to pay a beneficiary. If all those criteria are satisfied, the deposit is a special deposit.

Second, the Act clarifies the treatment of a special deposit in the event of the bankruptcy of a depositor. Under the current law of many states, it is unclear whether funds deposited into a special deposit could be swept into the bankruptcy estate of the person who deposited them. A special deposit under the Act is “bankruptcy remote” because Section 8 provides that neither a depositor nor a beneficiary has a property interest in a special deposit. No person is entitled to funds in a special deposit until the bank becomes obligated to pay a beneficiary. The only property interest that may arise with respect to a special deposit is in the right to receive payment from the bank after the occurrence of a contingency.

Third, the Act clarifies the applicability of creditor process on a special deposit. Under the current law, a creditor can freeze a special deposit and interfere with the purpose that the deposit is designed to achieve.

Section 9 of the Act provides that creditor process is not enforceable against the bank holding the special deposit, except in limited circumstances. Instead, creditor process may be enforceable against the bank holding a special deposit with respect to any amount that it must pay after the determination of a contingency, but not on the *special deposit itself*. Section 10 provides a similar limitation on using an injunction or temporary restraining order to achieve the same outcome.

Fourth, the Act provides clarity on the legality of the bank exercising a set off or right of recoupment against a special deposit that is unrelated to any payment to a beneficiary or the special deposit itself. Section 11 prohibits set off or recoupment except in limited circumstances.

Once a special deposit has been established under the Act, it creates an assignable and pledgeable interest for a beneficiary – a definite and clear right to payment upon the occurrence of a contingency and notice to the bank, where one may not otherwise exist. The Uniform Special Deposits Act creates a mechanism for parties to a commercial transaction to obtain a low cost and safe return on earnest money. The Uniform Special Deposits Act is narrowly tailored to cure these four legal uncertainties and eliminate doubts so that parties can utilize special deposits with greater confidence.



WHY COLORADO SHOULD ADOPT THE UNIFORM SPECIAL DEPOSITS ACT

A special deposit is a deposit of money at a bank where the person entitled to the money is only determined after a contingency occurs. Special deposits perform important work in commerce and industry throughout the United States. For example, consider a security deposit paid by a tenant to a landlord, or the deposit to an account that will fund the payment to members of a court-approved class action settlement. Special deposits could serve a variety of parties in business, commerce, and other various contexts, but legal uncertainties have led many to avoid using them.

The Uniform Special Deposits Act (the “Act”) cures the legal uncertainties that prevent businesses and commercial actors from making full use of the special deposit. Under the Act, parties will be able to utilize special deposits with greater confidence that their expectations will be met. Below are some of the reasons why Colorado should adopt the Uniform Special Deposits Act.

- **The Act is an “opt in” statute.** The parties must specifically elect to be covered by the Act in their account agreement. This means parties can elect to utilize the protections for certain deposit products and not others. The optional nature of the Act allows banks to add special deposits to the suite of products they offer without impacting existing arrangements. A bank can choose when and to what extent it will offer a special deposit to customers.
- **The Act was drafted with a minimalist philosophy.** The Act does not duplicate provisions of law governing deposits generally. Instead, it remedies uncertainties in the law surrounding the special deposit. Existing commercial and consumer protection laws supplement the Act, except where inconsistent.
- **The Act prevents parties from using a special deposit to defraud or hinder creditors.** A special deposit must serve a specified permissible purpose from the time the deposit is created until termination. If the deposit ceases to serve a permissible purpose before termination, the protections of the Act fall away, and the funds are subject to the payee’s creditors. For example, a deposit or transfer that is fraudulent or voidable under other law is not protected.
- **Under the Act, a special deposit cannot be swept into the bankruptcy estate of the depositor if there is a bankruptcy filing.** Under the current law of many states, a depositor will have rights to the special deposit before the determination of a contingency that resolves ownership of all or part of the balance of a special deposit. The Act makes it clear that any property interest with respect to a special deposit is the right to receive payment after the occurrence of the contingency—there is no property interest in the special deposit itself.

- **The Act protects special deposits from premature creditor process.** Under current law, creditor process can “freeze” a special deposit and interfere with the purpose that the deposit is designed to achieve. When the special deposit is established, the identity of the bank’s ultimate creditor has not been determined. Under the Act, creditor process is only enforceable against the bank holding the special deposit after the determination of a contingency.
- **The Act protects the special deposit from the bank’s set off right.** Under current law of certain states, a bank might exercise a right of set off or recoupment that is unrelated to a payment to a beneficiary (or to the special deposit itself). This has discouraged some from using special deposits. The Act prevents the bank from exercising a right of set off or recoupment to its own advantage with respect to unrelated debtor-creditor relationships.

The Act also clarifies other aspects of a special deposit relationship that have been muddled in the case law. For example, it expressly provides that the relationship between the bank and a beneficiary is a debtor-creditor relationship and that bank does not have a fiduciary duty to any person in connection with a special deposit.