

# PERSONAL PROPERTY SECURITY LAW

## CHAPTER ONE: CONCEPT OF SECURED FINANCING

### SECURED CREDITOR VS UNSECURED CREDITOR:

**Security Interest:** a property interest created by agreement or by operation of law over assets to secure the performance of an obligation, usually the payment of a debt

**Secured Debt:** goods/services/money exchanged for promise to pay in conjunction with collateral

#### Superior Rights of a Secured Creditor:

- Three distinct rights:
  - 1) **The Right of Enforcement;**
    - SP has superior right to proceed against the collateral in the event of a default, w/out a judgment against the debtor before doing so
    - Note: seizure must be undertaken by Civil Enforcement Agency
  - 2) **The Right to Priority; and**
    - Secured creditor obtains priority right against unsecured creditors
      - i. Secured party will be paid out before other unsecured creditors, however, where there is a deficiency, the SP will be on the same level as other unsecured creditors
  - 3) **The Right of Pursuit**
    - SP obtains a kind of property interest (security interest) in the collateral which gives the party the right to enforcement against the collateral in the event of default
    - This right will *generally* persist even though the debtor has transferred the collateral to a third party

**Unsecured Debt:** goods/services/money exchanged for promise to pay only

#### Unsecured Creditors' Remedies:

- An unsecured creditor is not permitted to immediately resort to the debtor's assets upon a failure to pay or other default
  - Must initiate a court action and obtain a judgment against the debtor for the amount of the debt, becoming a judgment creditor w/ a writ of enforcement which entitles the enforcement creditor to invoke a number of legal remedies
    - Three most widely used remedies:
      - 1) enforcement against personal property
        - civil enforcement agency seizes personal property of the debtor
        - after non-exempt personal property is seized and sold, the proceeds of the sale are available for distribution
          - the enforcement creditor is not necessarily entitled to all of this money; the enforcement creditor must generally share those proceeds with other enforcement creditors who have registered their writs in the PPR
          - **Civil Enforcement Act:**
            - **Limitations:** exemptions to seizure:
              - ie. an individual debtor may claim as exempt personal property used to earn income from the debtor's occupation up to a maximum of \$10,000
            - A debtor may challenge a seizure of personal property by completing a notice of objection; if this happens, the enforcement creditor must obtain a court order before taking any further steps against the property

- 2) enforcement against land
- 3) garnishment
  - creditor seeks to intercept money owing from some third party to the debtor (ie. bank account of debtor, wages owing by an employer to the debtor)

## CATEGORIES OF COLLATERAL:

### Chattel Paper:

*“one or more writings that evidence both a monetary obligation and security interest in or lease of specific goods or specific goods and accessions, but does not include a security agreement providing for a security interest in specific goods and after-acquired goods other than accessions”*

- one or more documents that evidence both the debtor’s monetary obligation and the property taken by the secured party in the debtor’s personal property
- in order to qualify, security interest must be restricted to specific goods
- includes leases of goods, whether or not they secure payment or performance of an obligation

### Documents of Title:

*“a writing issued by or addressed to a bailee that covers goods in the bailee’s possession that are identified or are fungible portions of an identified mass, and in which it is stated that the goods identified in it will be delivered to a named person, or to the transferee of the person, to bearer or to the order of a named person”*

- essentially receipts issued by bailees that evidence the fact that the bailee is holding the goods for a named person or to the transferee of that person
- Two types:
  - 1) Bills of Lading (issued by carriers)
  - 2) Warehouse Receipts (issued by warehouse keepers)

### Goods:

*“tangible property other than chattel paper, a document of title, an instrument, investment property and money, and includes fixtures, growing crops and the unborn young of animals, but does NOT include trees that are not crops until they are severed or minerals until they are extracted”*

- *“crops”: crops, whether matured or otherwise, and whether naturally grown or planted, attached to land by roots or forming part of trees or plants attached to land, but includes trees only if they are (i) nursery stock, (ii) trees being grown for uses other than the production of lumber or wood products, or (iii) trees being grown for use in reforestation of land other than the land on which the trees are growing*
- 1) **Consumer Goods:**
  - *“goods that are used or acquired for use primarily for personal, family or household purposes”*
- 2) **Inventory:**
  - *“goods (i) that are held by a person for sale or lease, or that have been leased by that person, (ii) that are to be furnished by a person or have been furnished by that person under a contract of service, (iii) that are raw materials or work in progress, or (iv) that are materials used or consumed in a business”*
    - *“used or consumed in a business”: goods that are in some sense used up (ie. pesticides and fertilizers that are applied to crops), rather than goods that are simply utilized as part of a business (ie. a truck that is used in a business to make deliveries)*
- 3) **Equipment:**
  - *“goods that are held by a debtor other than inventory or consumer goods”*
- **s. 1(5):** unless provided otherwise, characterization to occur at time the security interest attaches

### Instruments:

*“Means: a bill, note, or cheque within the meaning of the Bills of Exchange Act, any other writing that evidences a right to the payment of money and is of a kind that in the ordinary course of business is transferred by delivery with any necessary endorsement or assignment, or a letter of credit or an advice of credit if the letter or advice states that it must be surrendered on claiming payment under it, But does NOT include: Chattel paper, a document of title or investment property, or writing that provides for or creates a mortgage or charge in respect of an interest in land that is specifically identified in the writing”*

- writings that provide for the right to be paid money
- transferable by delivery with any necessary endorsement in the ordinary course of business
- ie. Cheques

### **Intangibles:**

*“personal property other than goods, chattel paper, investment property, a document of title, an instrument and money”*

- residual category
- ie. Account (right to payment of money)

### **Money:**

*“medium of exchange authorized by the Parliament of Canada or authorized or adopted by a foreign government as part of its currency”*

- does NOT cover bank accounts, bonds or promises to pay money

### **Investment Property:**

*“a security, whether certified or uncertificated, security entitlement, securities account, futures contract or futures account”*

- *“security”: an obligation of an issuer or a share, participation or other interest in an issuer or in property or an enterprise of an issuer (i) that is represented by a security certificate in bearer form or registered form, or the transfer of which may be registered on books maintained for that purpose by or on behalf of the issuer, (ii) that is one of a class or series, or by its terms is divisible into a class or series, of shares, participations, interests or obligations, and (iii) that (a) is, or is of a type, dealt in or traded on securities exchanges or security markets, or (b) is a medium for investment and by its terms expressly provides that it is a security for the purposes of the Act*
- *“security entitlement”: rights and property interest of an entitlement holder with respect to a financial asset*
  - represents an obligation owed by a broker or other intermediary to its customer in respect of securities it holds
  - customers typically acquire shares from a financial institution and do not have a direct relationship with the issuer; the shares are recorded in the name of some other party who holds them for the benefit of the customer
- *“securities account”: an account to which financial asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights that constitute the financial asset*
- *“futures contract”: a standardized future or an option on futures, other than a clearing house option, that is (i) traded on or subject to the rules of a futures exchange recognized or otherwise regulated by the Alberta Securities Commission or by a securities regulatory authority of another province or territory of Canada, or (ii) traded on a foreign futures exchange and carried on the books of a futures intermediary for a futures customer*
- *“futures account”: an account maintained by a futures intermediary in which a futures contract is carried for a futures customer*

## **EXAMPLES:**

- 1) A, B, and C are creditors of D. D owns a truck worth \$40,000 and other assets worth \$80,000. A is owed \$50,000, B is owed \$50,000 and C is owed \$100,000. As security for the loan, D gives a security interest in the truck to A. The security interest is properly perfected by registration in the personal property registry. How should the funds resulting from the sale of D’s assets be distributed among A, B, and C?
  - b/c A is a secured creditor, A will be paid the \$50,000 first. The rest of the property will be divided amongst B and C based on CL principles/remedies available to unsecured creditors
  - If B or C had a writ of enforcement, they would beat out the other, if both of them had a writ of enforcement they would be divided equally.
- 2) What would be the distribution if A was unable to assert its secured creditor status b/c of an error in its registration?
  - If any of the parties had a writ of enforcement, that party would beat out the other unsecured creditors; if not, it would be divided amongst the remaining parties equally

### FINANCING TECHNIQUES:

s. 3(2): this Act applies to (a) a transfer of an account or chattel paper, (b) a lease of goods for a term of more than one year, and (c) a commercial consignment, that does not secure payment or performance of an obligation.

#### Loan Credit:

- Lender owes money to buyer (debtor), lender takes out security interest to lessen their risk in the chance of default by the debtor. The buyer/debtor uses the proceeds of the loan to pay off the seller (3<sup>rd</sup> party)
  - In many cases the lender will take a security interest in the goods that are acquired
    - Can be the good that the loan was acquired for, can be something else, can be a combination of things

#### Sales Credit:

- Where you don't have a lender but rather, the seller provides the secured credit sale and becomes the lender/seller: the seller retains a security interest in the goods it sells to the buyer/debtor, until the full purchase price and credit charges are paid in full
- The seller can also transfer rights to the security interest, for example to a financing company
  - Property in the hands of the buyer: goods
  - Property rights in the hands of the seller: right to the installments and the security interest= chattel paper

#### Leasing:

- True lease is NOT a security interest: giving possession of the property in exchange for money for a certain amount of time for the use of the property during that time, to be given back at the end of that period
- The lessor can assign the lease to a finance company and finance company sends Notice of Assignment to Lessee
  - Lessor's right: chattel paper
- Alternate Structure: leasing company facilitating the acquisition of the asset by acquiring the good from the seller and then leasing the goods to the lessee

#### Accounts Financing:

- Business provides goods or services and that is often for unsecured goods, the customers owe payment obligations to the business
- When a business wants to obtain a loan they can use the money owed by customers as collateral for the loan
  - Typically done on a non-notice way: the lender of the loan to the business does not tell the customers of the business to pay up—the business will collect the accounts (b/c carrying on business so getting new accounts and collecting from older customers)—enforcement (going directly to customers to pay up) will occur only if there is a default

#### Factoring:

- Customers have payment obligations owing to the business and the business enters into a factoring company. The factoring company does not loan money to the business but the accounts payable are sold to the factoring company and the factoring company becomes the owner of the accounts owing by the customers
- Notification is given to the customers in the way of a Notice of Assignment
- Originated in New York, out of the fashion industry
- Deemed security interest

### SCOPE OF THE PPSA:

#### True Security Interests:

s. 3(1): this Act applies to:

*(a) every transaction that in substance creates a security interest, without regard to its form and without regard to the person who has title to the collateral, and*

*(b) without limiting the generality of clause (a), a chattel mortgage, conditional sale, floating charge, pledge, trust indenture, trust receipt, assignment, consignment, lease, trust and transfer of chattel paper where they secured payment or performance of an obligation.*

#### Four Requirements:

- 1) transaction creates a property interest in asset;
- 2) asset is personal property;
- 3) secures payment or performance of an obligation; and
- 4) arises out of an agreement between the parties

#### Deemed Security Interests:

##### s. 3(2): this Act applies to

(a) a transfer of an account or chattel paper,

(b) a lease of goods for a term of more than one year, and

*“lease for a term of more than one year”:*

- (i) a lease for an indefinite term even though the lease is determinable by one or both parties within one year after its execution,
- (ii) a lease initially for one year or less than one year if the lessee, with the consent of the lessor, retains uninterrupted, or substantially uninterrupted, possession of the leased goods for a period in excess of one year after the date the lessee first acquired possession of the goods, and
- (iii) a lease for a term of one year or less that is automatically renewable or that is renewable at the option of one of the parties, or by agreement, for one or more terms, the total of which, including the original term, may exceed one year

*but does not include*

- (iv) a lease involving a lessor who is not regularly engaged in the business of leasing goods,
- (v) a lease of household furnishings or appliances as part of a lease of land where the goods are incidental to the use and enjoyment of the land, or
- (vi) a lease of any prescribed goods regardless of the length of the term of that lease

(c) a commercial consignment,

*“commercial consignment”:* means a consignment under which goods are delivered for sale, lease or other disposition to a consignee who, in the ordinary course of the consignee’s business, deals in goods of that description, by a consignor who,

- (i) in the ordinary course of the consignor’s business, deals in goods of that description, and
- (ii) reserves an interest in the goods after they have been delivered,

*But does not include an agreement under which goods are delivered to an auctioneer for sale or to a consignee for sale, lease or other disposition if it is generally known to the creditors of the consignee that the consignee is in the business of selling or leasing goods of others*

*that does not secure payment or performance of an obligation.*

#### Determining What Kind of Interest You Have:

##### 1) Is it a true security interest?

a. **Substance Test:** does the transaction, in substance, create a security interest?

##### i. Requirements:

- 1) transaction creates a property interest in asset
- 2) asset is personal property
- 3) secures payment or performance of an obligation
- 4) arises out of an agreement between the parties

ii. A is given a lease for a term of three years with the option to buy at the end of that term for \$1. Lessee pays payments for 3 years and then pays the \$1.

- Look to the Option Clause:
  - where the option price is significantly lower than the suspected value of the goods at the end of the term, a reasonable lessee will be expected to purchase the goods at the end of the true lease
    - i. then economically no different than if the lessor sold the purchase price and financed the good = Security Interest
  - where the option price at the time of the contract is a reasonable pre-estimate for the goods at the end of the term= NOT security interest but a lease with an option to purchase

iii. A enters into a lease for computers for a computer lab for a term of 5 years. The expectation is that after 5 years the technology will be outdated and the use will be so heavy that the computers will be useless.

- Where the lease is for the entire useful life of the goods= security interest under s. 3(1)

iv. A enters into a consignment with B. B is agent for A to resell the goods. The consignment terms say that B is supposed to return the wholesale value of the goods, whether they are sold or not.

- In substance a security interest b/c A is financing the goods essentially
- **TEST:** does the consignee have the rights to return the goods if the buyer cannot be found?
  - **If yes:** not a security interest
  - **If no** and the consignee is required to buy the goods/pay for them in some way: security interest

2) If not a true security interest, does it fall under s. 3(2) as a deemed security interest?

- a. A transfer of account or chattel paper?
- b. A lease of goods for a term of more than one year?
- c. Commercial consignment?

**Three Possibilities:**

- 1) The interest secures payment or performance of an obligation, even if a lease or consignment → PPSA applies
- 2) A lease/consignment does not secure payment or performance of an obligation but falls under the definition of “lease more for a term of more than on year” or “commercial consignment” → PPSA applies, EXCEPT s. 5
- 3) Lease/consignment does not secure payment or performance and does not fall under the def’ns of “lease for a term of more than one year” or “commercial consignment” → PPSA does NOT apply

**Remedies:**

- Where the PPSA does not apply or is a Deemed Security Interest: contractual rights and remedies would comply with those set out in the lease and any CL rights and remedies
- Where the PPSA does apply: limited to statutory remedies

**Exceptions:**

**s. 4: exceptions to this Act:**

non consensual security interests such as possessory liens or a landlord’s right to distrain for unpaid rent; transfer of an interest in land; federal security interests, etc.

**Def’ns:**

<b>Acceleration Clause:</b>	A term that fully matures the performance due from a party upon a breach of the contract
<b>Open End Lease:</b>	A termination value is set in the contract (a pre-estimate of the value of the goods at the end of the lease term). At the end of the lease term, the goods are returned by the lessee to the lessor. The lessor sells the goods and the proceeds of the sale are compared to the termination value: If the lessor sells the goods at a loss, the lessee is entitled to make up that deficit If the lessor sells the goods at a gain, the lessee is entitled to the surplus.

**CASE LAW:**

***DaimlerChrysler Services Canada Inc v Cameron (2007 ABBCA):***

**Facts:** C signed a lease for a truck. C was the lessee. Vernon Chrysler Dodge was the dealer. The lease provided that V would assign the lease to DaimlerChrysler, which was assigned on the same day the lease was signed. The lease was for 48 months and C was to pay approx. \$1000/month and other obligations. DC alleged that C failed to make the payments under the lease and repossessed the truck and sold it.

**Issue:** Does the lease of the goods fall under the PPSA, such that s. 5 remedies apply? Is the presence of an acceleration clause in a lease agreement evidence that the transaction in substance creates a security interest?

**Held:** Part 5 does not apply to the lease agreement in question. An acceleration clause is not unique to a security interest alone. Deemed security interest, therefore, part 5 does not apply.

**Ratio:** Presence of an acceleration clause is not evidence that a lease should be characterized as a security interest. The qualification of the interest is based on the substance.

***Re Cronin Fire Equipment Ltd (1993 ONSC):***

**Facts:** C leased a number of vehicles from T. The lease agreement was that effectively all benefits and risk of ownership of the vehicles was transferred to C. T registered the leases which were valid for three years on May 2, 1988. C went bankrupt. TD became the trustee in bankruptcy and registered on May 28, 1992. T renewed financing statement on June 2, 1992.

**Issue:** is an open-end lease a transaction that in substance creates a security interest under s. 3(1)?

**Held:** Even though the lessee never ends up the true owner of the goods, it is a security interest b/c the lessee has the benefit of any gain and takes the risk of any loss while the lessor is assured of a fixed return on its investment that it will get the same amount in return, regardless.

**Ratio: Open End Leases are true security interests. If lessee benefits from gains and suffers losses then the benefits of ownership imposed lessee → disguised SI.**

***Canadian Imperial Bank of Commerce v Westfield Industries Ltd (1990 SKQB):***

**Facts:** S is a retail vendor of agricultural machinery and farm implements. CIBC made a loan to S under a GSA which was registered. W is a business that manufactures, distributes, and sells short-line farm implements, primarily grain augers. W delivered 5 grain augers in total to S on a "consignment basis". Title to the grain augers remained with W and S was not responsible to W for any money unless and until the augers were sold to a retail buyer. W did not register.

**Issue:** Priority in respect of three grain augers in possession of W: Is the business of S generally known in the area in which it carried on business to be selling or leasing the goods of others, such that it qualifies as a consignment?

If W's arrangement under the PPSA: W will lose priority b/c not registered and CIBC is secured so they will be able to enforce their priority

If W's arrangement does not fall under the PPSA: W will be able to claim priority over CIBC b/c they are the owners of the equipment

**Held:** CIBC has priority interest as registered security holder over W. There is no evidence that any buyer could have known that S sold the goods of others on a consignment basis. There is no evidence that creditors (perhaps other than CIBC) would have known S to be selling the goods of others.

**Ratio: To determine "known in the area" look to the general knowledge of persons who might be expected to deal with the consignee as creditors, buyers or lessees. It is not whether a particular creditor would know but that it is generally known that these sorts of assets are being sold on a consignment basis.**

***Saulnier v Royal Bank of Canada (2008 SCC):***

Note: did not discuss in class

**Facts:** S has four fishing licenses. S took a loan out from RBC to finance his business and executed a GSA that gave RBC a security interest in "all present and after acquired personal property including...intangibles". S went bankrupt. Four months after the bankruptcy S leased his lobster license to H. Five months later, the trustee in bankruptcy signed an agreement to sell S's fishing licenses and other assets to a third party. S refused to sign the necessary documents. Trustee in bankruptcy and RBC brought application.

**Issue:** whether a commercial fishing license, which enables a fisher to engage in a regulated industry where participation is otherwise prohibited, constitutes "property" available to a trustee under the federal *Bankruptcy and Insolvency Act*, or a creditor who has registered a GSA under the Nova Scotia PPSA?

**Held:** the trustee was entitled to require S to execute the appropriate documentation to obtain a transfer of the fishing licenses to the third party purchaser. The components of the "bundle of rights" invested the license holder with property-like rights sufficient to bring the licenses within the *BIA* and *PPSA*. The registration was valid and RBC was entitled to proceed with its *PPSA* remedies, absent any other *PPSA* defences.

**Reason:** The holder of the fishing license acquires the right to engage in an exclusive fishery under the conditions imposed by the license and a proprietary right in the wild fish harvested thereunder and the earnings from their sale.

The purpose of the *BIA* is to allow the bankrupt party to continue living pending discharge and, when discharged, to make a fresh start.

**Ratio: a license issued by the Crown that grants more than just a right to do something that is otherwise illegal [ie. a property right in the harvest of that license] is considered "property" for the purposes of the *Bankruptcy and Insolvency Act* and the *Personal Property Security Act*.**

## EXAMPLES:

- 1) A true lease that does not fall within the definition of a “lease for a term of more than one year” is not governed by the PPSA at all. How are priority competitions and inter-party disputes governed when dealing with these true leases? Consider the following scenarios:
  - (a) Secured Party has taken security interest in all of Debtor’s present and after-acquired personal property. Lessor leases goods to D under a true lease that does not fall within the scope of the PPSA. SP registers a financing statement in the Personal Property Registry but L does not do so. D goes insolvent and SP and L claim the goods. Who has priority between SP and L?
    - D has security interest in the property but that does not include the lessor
    - Look to the Common Law
    - If you are outside the scope of the PPSA, you don’t have to register as a lessor
  - (b) L leases goods to D under a true lease that does not fall within the scope of the PPSA. L does not register a financing statement in the Personal Property Registry. D goes bankrupt. Who has priority between the trustee in bankruptcy and L?
    - The lessor will prevail over the trustee in bankruptcy because the lessor is able to assert its title as the lessor
    - If within the PPSA, this changes: ie. deemed security interest, then there is a registration requirement and failure to register renders the interest ineffective against the bankruptcy trustee
  - (c) L leases goods to D under a true lease that does not fall within the scope of the PPSA. L does not register a financing statement in the PPR. D sells the goods to B. Who as between B and L has priority?
    - If outside the scope of the PPSA, apply the CL and CL priority says : equal debt—you can’t give what you don’t have—the lessor has legal title so the lessor prevails over the innocent buyer
      - i. Bona Fide purchaser for value only defeats an equitable title
    - If within the scope of the PPSA: apply priority rules: innocent buyer priority b/c of the lack of registration of L
  - (d) L leases goods to D under a true lease that does not fall within the scope of the PPSA. D defaults under the lease contract. What remedies does L have against D or against the goods?
    - If within PPSA, s. 5 applies for remedies (where not deemed or outside scope of PPSA)
    - Where deemed security interest or outside the scope of the PPSA: CL applies
    - Contract law defines the extent to which you can recover the unpaid lease payments: assess damages for breach of contract and lease breaches that obligation
- 2) You have been retained by a cattle feeder association. The association seeks a legal opinion concerning the validity of their standard form feeder association agreement and wishes to be advised about any other steps that it should take in order to protect its rights. The arrangement is as follows. A feeder association acquires cattle and brands them (or identifies them with an ear tag) in the name of the feeder association. The feeder association then enters into an agreement with a member of the feeder association who takes possession of the cattle and raises them. The agreement provides that the legal title to the cattle remains with the feeder association. It also provides that the cattle will not be relocated without the consent of the feeder association and the feeder association has the right to inspect them. The member is responsible for maintaining the health of the cattle, must provide them with veterinary services and must insure the cattle. The feeder association provides credit to the member to permit the purchase of feed. When the cattle are sold, the charges payable to the feeder association are paid and the balance is paid to the producer.
  - Issue: has the producer given the feeder association an interest in the producer’s property that secures payment or performance of the obligation?
  - Look to the economic reality of the agreement, not the legal form
  - The lessee takes all the benefit of any gain but holds the risk of any loss, therefore, likely a security interest
  - To give the feeder association priority, it has to be registered
- 3) A close personal friend comes to you with a tale of woe. Your friend has collected coins for many years and has built a substantial and valuable collection. In order to finance the final year of study in law school, your friend decided that there was no alternative but to sell the coin collection. The collection was delivered to Big Coin Dealers Ltd on the understanding that the dealer would sell the collection to its customers and retain 10% of the sale proceeds. The balance was to be remitted to your friend. In the event that the coin collection could not be sold, Big Coin Dealers Ltd. agreed to return it. Your friend was horrified to learn today that Big Coin Dealers Ltd has gone into bankruptcy. The trustee in bankruptcy has refused to return the collection. What is your friend’s legal position?
  - Is this within the scope of the PPSA?
    - i. It may be a security interest and fall under the PPSA
    - ii. Alternatively, it could be a deemed security interest in which case everything but the priority rules will apply
  - Is it a true security interest per s. 3(1)?
    - i. No; when looking at consignment stuff focus on whether the party had the right to return the goods if they weren’t sold

1. Here the consignee has the right to return the goods if they aren't sold—it really is an agency relationship
- Is it a deemed security interest per s. 3(2)?
    - i. The act allows commercial consignment to be a deemed security interest so look to def'n of "commercial consignment"
    - ii. This is not a commercial consignment b/c the consignor is not in the business of dealing with the goods—this is an ad hoc sale

### LEGISLATION:

- s. 5(1):** the validity, perfection and effect of perfection or non-perfection of
- (a) a security interest in goods, and
  - (b) a possessory security interest in chattel paper, a negotiable document of title, an instrument or money,
- is governed by the law of the jurisdiction where the collateral is situated at the time the security interest attaches
- s. 5(2):** a security interest in goods perfected under the law of the jurisdiction in which the goods are situated at the time the security interest attaches but before the goods are brought into the Province continues to be perfected in the Province if it is perfected in the Province
- (a) not later than 60 days after the goods are brought into the Province,
  - (b) not later than 15 days after the day the secured party has knowledge that the goods have been brought into the Province,
- or
- (c) prior to the date that perfection ceases under the law of the jurisdiction in which the goods were situated when the security interest attached,
- whichever is the earliest, but the security interest is subordinate to the interest of a buyer or lessee of the good who acquires the buyer's or lessee's interest without knowledge of the security interest and before it is perfected in the Province under s. 24 or 25.
- s. 5(3):** a security interest that is not perfected as provided in subsection (2) may be otherwise perfected in the Province under this Act.
- s. 5(4):** if a security interest is not perfected under the law of the jurisdiction in which the collateral was situated at the time the security interest attached and before the collateral was brought into the Province, it may be perfected under this Act.
- s. 6(1):** subject to s. 7,
- (a) if the parties to a security agreement that creates a security interest in goods in one jurisdiction understand at the time the security interest attaches that the goods will be kept in another jurisdiction, and
  - (b) if the goods are removed to the other jurisdiction, for purposes other than transportation through the other jurisdiction, not later than 30 days after the security interest attaches,
- the validity, perfection and effect of perfection or non-perfection of the security interest shall be governed by the law of the other jurisdiction
- s. 6(2):** If the other jurisdiction referred to in subsection (1) is not the Province and the goods are later brought into the Province, the security interest in the goods is deemed to be a security interest in the goods to which section 5(2) applies if it was perfected under the law of the jurisdiction to which the goods were removed.
- s. 7 (1):** A debtor is deemed to be located
- (a) at the debtor's place of business, if the debtor has a place of business,
  - (b) at the debtor's chief executive office, if the debtor has more than one place of business, and
  - (c) at the debtor's principal residence, if the debtor has no place of business
- s. 7(2):** Validity, perfection and effect of perfection or non-perfection of
- (a) a security interest in
    - (i) an intangible, or
    - (ii) goods that are of a kind that are normally used in more than one jurisdiction, if the goods are equipment or are inventory leased or held by the debtor to others, and
  - (b) a non-possessory security interest in chattel paper, a negotiable document of title, an instrument or money, must be governed by the law, including the conflict of law rules, of the jurisdiction where the debtor is located at the time the security interest attaches
- s. 7(3):** If the debtor relocates to another jurisdiction or transfers an interest in the collateral to a person located in another jurisdiction, a security interest is perfected in accordance with the applicable law as provided in subsection (2) continues perfected in the Province if it is perfected in the other jurisdiction
- (a) no later than 60 days after the debtor relocates or transfers an interest in the collateral to a person in the other jurisdiction,
  - (b) not later than 15 days after the day the secured party has knowledge that the debtor has relocated or has transferred an interest in the collateral to a person located in the other jurisdiction, or
  - (c) prior to the day that perfection ceases under the law of the first jurisdiction, whichever is the earliest

## CHOICE OF LAW:

- Provisions that govern perfection are extremely important b/c they determine the jurisdiction where registration must be effected
  - A registering party who does not understand these rules is liable to register in the wrong jurisdiction resulting in loss of priority
  - A searching party who does not understand these choice of law rules is liable to search the wrong registry and risk not discovering the existence of a competing security interest
- **1) Location of the Collateral (s. 5)**
  - **Rule:** validity and perfection of a security interest is to be determined by the law of the jurisdiction where the property is located at the time the security interest attaches
  - **Relocation: (s. 5(2))**
    - SP required to take steps to perfect the security interest in the new jurisdiction
    - **Grace period (s. 5(2))**
      - 60-day period, from the time the goods are brought into Alberta
      - 15-day period, if the SP knows of their removal, from the date of knowledge
    - **Exception: (s. 6)**
      - Applies only if the parties understand that the goods are going to be located in another jurisdiction and the goods are removed not later than 30 days after the security interest attaches
        - The validity and perfection of the security interest is governed by the law of the jurisdiction into which the goods are re-located
        - **Farmer in Alberta purchases a piece of agricultural machinery from an agricultural dealer in Saskatchewan. The dealer is told that the farmer plans to take the goods into Alberta and the farmer transports the goods into Alberta ten days later. Alberta is the proper place for perfection of the security interest.**
- **2) Location of the Debtor (s. 7)**
  - **Rule:** determined by the law of the jurisdiction where the debtor is located at the time of attachment of the security interest
    - **“Location of the Debtor” (s. 7.1)**
  - **Applies to:**
    - 1) Intangibles
    - 2) Mobile goods held as equipment
    - 3) mobile goods held as inventory by a lessor
    - 4) non-possessory security interests in documentary intangibles other than investment property
      - Chattel paper, instruments, documents of title, and money are covered by s. 5 if the SP takes possessory security interest in them (perfection by possession), otherwise s. 7 applies
  - **Grace Period (s. 7(3)):**
    - 60-day period, from the time the goods are brought into Alberta
    - 15-day period, if the SP knows of their removal, from the date of knowledge
- **Operation of Grace Periods:**
  - Provide periods of temporary condition perfection
    - If the SP is able to perfect the security interest in the new jurisdiction, within the grace period, then the security interest will be considered to be continuously perfected from the date of its original perfection in the other jurisdiction
    - If the SP fails to perfect within the grace period, the security interest will not be considered to be perfected until it is actually perfected in the new jurisdiction
      - **The debtor, a resident of Manitoba, gives SP1 a security interest in an automobile held as consumer goods on Feb 28. The goods are moved to Alberta on May 10. The debtor then grants a security interest to SP2, who registers in Alberta on June 6. On August 1, SP1 learns of the relocation and registers in Alberta.**

- SP1's security interest is considered to be perfected only from the date of its registration in Alberta, therefore, SP2 has priority over SP1.
- **Investment Property (s. 7.1):**
  - Certified Security: jurisdiction in which the certificate is located
  - Security certificate perfected by registration: location of the debtor
  - Uncertified Security: issuer's jurisdiction
  - Security entitlement: intermediary's jurisdiction
    - However, jurisdiction of intermediary may be designated by agreement

## CASE LAW:

### *Gimli Auto Ltd V BDO Dunwoody LTD (1998 ABCA):*

**Facts:** Lessee was in the business of renting out trucks with campers on them to tourists for short periods of time. Lessee did not own the vehicles but rented them for a term of three years from G. G carries on business in Manitoba and the lease was entered into there. The lease was never registered. Lessee brought the trucks to Alberta where its chief place of business was. Lessee also entered into a long term lease of a passenger vehicle in BC and was registered in BC. Lessee then went bankrupt. Nothing was registered in Alberta.

**Issue:** Priority dispute over motor vehicles between two lessors and the lessee's trustee in bankruptcy. Does s. 7 apply to the lease trucks such that it prevails?

**Held:** s. 7 applies to leased trucks and Alberta law governs b/c the lessee had its chief executive office in Alberta. There was no registration so the lessor's interest was not perfected and the trustee in bankruptcy of the lessee prevails under s. 20.

The car under the BC lease qualified as equipment under s. 7(2)(a)(ii) and the governing legislation is where the debtor is located and where the debtor is located is defined by s. 7(1) by his place of business—Alberta. As there was no registration in Alberta, the lessor's interest was not perfected before bankruptcy so the trustee would prevail.

**Ratio:** Where the lessor's interests have not been registered in the governing province before bankruptcy occurs, the trustee in bankruptcy will prevail.

## EXAMPLES:

- 1) Polyanna Products Inc runs a business manufacturing and distributing business across Western Canada. The corporation gave a general security interest in all of its present and after-acquired personal property to the Alberta Treasure Bank (ATB) in order to secure an operating line of credit. Although the corporation originally started up in Victoria, BC and was enacted under the BC *Business Corporations Act*, the head office and major manufacturing plant are now located in Edmonton, Alberta and the major managerial business decisions are made in Edmonton. The manufacturing plant in Alberta consists primarily of heavy equipment and machinery, as well as the raw product and the finished product. As well, there are computers and office equipment located at the head office in Edmonton. There is a secondary manufacturing plant located in Saskatchewan. The manufacturing plant in Saskatchewan is made up of heavy equipment and machinery, as well as the raw product and the finished product. In addition, there are three trucks used solely in Saskatchewan to make local deliveries. There is a computer system and some office furniture located in the Victoria office, and also some cash and cheques that have not yet been deposited in the corporation's bank account. The bank account is currently in overdraft position. Most of the customers that purchase the product are located in BC. Where must ATB register its security interest?
  - Issue is whether an over-drafted bank account counts as a security interest?
  - An overdraft is not an asset, it is a liability so that's why we don't recognize them as security interests
  - If the debtor is a corporation, that's incorporated under provincial statute then that's the jurisdiction that we use; where under CBCA, use the registered office or head office for jurisdiction
- 2) How, if it at all, would the result in question 1 differ in the following scenario? There are two corporations—Polyanna Products (Western Canada) Inc, which owns all the assets located in Alberta and BC and to whom all amounts generated from sales are payable, and Polyanna Products (Sask) Inc, which has its head office in Saskatoon and which owns all assets located in Saskatchewan. ATB makes the loan to Polyanna Products (Western Canada) Inc and Polyanna Products (Sask) Inc guarantees it. Each corporation gives ATB a security interest in all their present and after-acquired personal property. Polyanna Products (Saskatchewan) Inc is a wholly owned subsidiary of Polyanna Products (Western Canada) Inc.
  - S. 5(2) deals with the location of the collateral
  - The PPSA does not put all the risk on the original secured party or the newly secured party—it gives temporary period of perfection which after a period of time will stop operating
  - Manitoba will apply their PPSA to determine the conflict of laws provision issues
  - Who has priority between ATB (SP) and the Credit Union (who took security interest in Manitoba)?

- This is not a mobile good but a heavy piece of machinery
- The Sask registration is only good for 60 days, it would only be shortened if the registered security interest holder had been notified in 15 days—this was done here
- So when we have priority competition between the two secured parties we look to the first in time to register
- But we are treating the Saskatchewan registration as continuing, therefore, ATB has priority over credit union even though the Manitoba registry search would return nothing
- Once the 60 days has passed, ATB no longer has a secured interest

# CHAPTER FOUR: THE SECURITY AGREEMENT

## SECURITY AGREEMENT

### LEGISLATION:

**s.10(1):** a security interest is enforceable against a third party only where

(a) ... is in the possession of the secured party,

(d) the debtor has signed a security agreement that contains

(i) a description of the collateral by item or kind or as “goods”, “chattel paper”, “investment property”, “documents of title”, “instruments”, “money” or “intangibles”

(ii) a description of collateral that is a security entitlement, securities account, or futures account if it describes the collateral by those terms or as “investment property” or if it describes the underlying financial asset or futures contract,

(iii) a statement that a security interest is taken in all of the debtor’s present and after-acquired personal property, or

(iv) a statement that a security interest is taken in all of the debtor’s present and after acquired personal property except specified items or kinds of personal property or except personal property described as “goods”, “chattel paper”, “investment property”, “documents of title”, “instruments”, “money” or “intangibles”

**s. 10(2):** For the purposes of subsection (1)(a), a secured party is deemed not to have taken possession of collateral that is in the apparent possession or control of the debtor or the debtor’s agent

**s. 10(3):** a description is inadequate for the purposes of subsection (1)(b) if it describes the collateral as consumer goods or equipment without further reference to the kind of collateral

**s. 10(4):** A description of collateral as inventory is adequate for the purposes of subsection (1)(b) only while it is held by the debtor as inventory

**s. 10(5):** a security interest in proceeds is not unenforceable against a third party by reason only that the security agreement does not contain a description of the proceeds

### ENFORCEABILITY:

**s. 10** establishes criteria that must be satisfied before a security interest is enforceable against a third party:

- b/c a secured party trumps an unsecured party, a third party may expect there to be some evidence that the secured party and the debtor have in fact entered into such agreement
  - if you claim a security interest against a third party, who is claiming competing rights to that asset, then s. 10 requirements have to be satisfied
- **Two ways:**
  - **1) Possession, or**
    - has to be visible and apparent in the hands of the *secured party* (not the debtor)
    - Practice Point: secured parties well advised to execute a written security agreement anyways
  - **2) Written Security Agreement:**
    - **per s. 10(1)(d):**
      - **1) written security agreement,**
      - **2) signed by the debtor, and**
        - issues may arise in regards to corporations and whether the individual who signed the SA was authorized to do so
          - if the signing party has actual or apparent authority= binds the corporation
      - **3) containing a description of the collateral**
        - Authorized Collateral Descriptions: (**s. 10(1)(d)**)
          - 1) Description by item
            - identifies each specific piece of property
              - ie. automobile by make, model, serial number
          - 2) Description by kind
            - uses a generic class description
              - ie. “all computers”; “all goods and accounts”
          - 3) All inclusive description
            - “all present and after acquired personal property”
          - 4) All inclusive description subject to specified exceptions

- “all present and after acquired personal property except [specific item or kind]”
- Unauthorized Collateral Descriptions: (s. 10(3)/s. 10(4))
  - A description that merely describes the collateral as “consumer goods” or “equipment” is not sufficient
    - b/c these sorts of descriptions depend upon the debtor’s use of the collateral, rather than describing the attributes of the collateral
  - “inventory” is acceptable, but limitation that only so long as the collateral is held by the debtor as inventory
- **Note:** Failure to comply w/ s. 10 does not invalidate the security interest between the secured party and the debtor—affects the secured parties dealing with third parties (ie. other secured creditors/unsecured creditors)
- **After Acquired Property:**
  - A security agreement can create a security interest in after-acquired property, and the *PPSA* does not draw a distinction between present property and after-acquired property for the purposes of priority competitions
    - **Exception:**
      - An after-acquired property clause in an SA will not be effective in the case of “consumer goods, other than an accession, unless the security interest or a security interest in collateral obtained by the debtor as replacement for collateral described in the security agreement”
      - **A makes a purchase-money loan to B to finance B’s purchase of a sail boat. A security agreement is executed and money is advanced to B. The agreement contains a provision under which B purports to grant a security interest in “any automobile hereafter acquired by debtor”. B buys a sail boat. B later buys a car for personal use.**
        - Both the sail boat and car are classes as “consumer goods” and both were acquired after the security agreement was executed and are considered after-acquired property
        - The security interest in the sail boat is a purchase money security interest and thus attaches to the sail boat, despite it being an after-acquired consumer goods
        - The security interest in the car is not a purchase money security interest and the after-acquired property clause is ineffective
          - Seizure of the automobile by the secured party will constitute an illegal seizure and render the secured party liable to damages

## ELEMENTS OF A GENERAL SECURITY AGREEMENT:

<b>Charging Clause</b>	Identifies the collateral and provides the debtor transfers a security interest in it from the debtor to the secured party
<b>All Obligations/All Monies Clause</b>	“all present and after acquired party”
<b>Representation/Warranty</b>	Statement of fact given by one party to another in order to induce that party to enter into the contract Often relate to three key areas: <ol style="list-style-type: none"> <li>1) Condition of the collateral;</li> <li>2) Business condition of the debtor; and</li> <li>3) Status of the debtor</li> </ol>
<b>Covenant</b>	Promise made by a party to a contract to do (positive covenant) or not to do (negative covenant) a specified action; a promise as to the future conduct of the debtor Ensure that the collateral is maintained in good condition, insured, and not removed from the jurisdiction Limit the ability of the debtor to carry on business in a manner that would adversely affect the secured party by the riskiness of the loan, Give the secured party access to the information so that it can better monitor the debtor Give the secured party the ability to terminate the contract and call for repayment of the loan
<b>Cross Default Clause</b>	Provides that it is an event of default if the debtor is in default of an obligation with some other person

	D has a loan with SP1 in good standing but the debtor is in default of a loan obtained from SP2. SP1's security agreement contains a cross-default clause, therefore, a default under SP2s security agreement will trigger a default under SP1s agreement.
<b>General Insecurity Clause</b>	Permits the secured party to declare an act of default if the secured party deems itself to be insecure or believes that the collateral is in jeopardy <b>S.16:</b> limits the effectiveness of this type of provision by providing that the secured party must be in good faith and have commercially reasonable grounds for this belief before being entitled to accelerate payment of the loan
<b>Acceleration Clause</b>	Gives the secured party the right to accelerate the future scheduled loan repayments so that these payments become immediately due and payable upon the event of a default <b>s. 63(1)(b):</b> modifies the operation by giving the debtor the right to reinstate the security agreement by curing the default irrespective of acceleration clause

## CASE LAW:

### ***Guntel v Kocian (1985 Man QB):***

**Facts:** K and W started a relationship. K bought truck from T, financed by S w/ security agreement (registered). W urged K to get truck for him; W convinced K to register truck in his name under the promise to make all payments to S and if he did not, K would be entitled to have the truck returned to her. The two parties executed a handwritten document to this effect. K registered her "security interest" by a financing statement. W sold the truck to G. G secured financing from CIBC and registered his interest the day after K's registration. A previous search by CIBC showed no previous registrations for the vehicle (an error in the serial number for S's security interest and an end-of-day filing that was not registered until the following day for K's interest).

**Issue:** The validity, if at all, of K's security interest and enforceability of her security agreement against third parties, G and CIBC?

The handwritten agreement between K and W shows that W acknowledges a debt to K in the amount of \$7,699+ interest of S for the truck. The truck itself is clearly defined by year, make, and serial number. Is this nothing more than an IOU or does it create a valid security interest that secures payment or performance of an obligation?

**Held:** K has priority over CIBC/G. The evidence presented by K clearly shows that the agreement between her and W was intended to secure the performance by W of his obligation to make all payments that K herself had undertaken in respect of the S loan and the written agreement meets all the statutory requirements of a valid security agreement. K has perfected her security interest by the time G received the assignment of ownership from W.

**Ratio:** Where a security agreement satisfies the statutory requirements, however simple it might be, and that security agreement is perfected, the secured party will have priority over subsequently registered parties.

### ***GE Capital Canada Acquisitions Inc v Dix Performance (Trustee of) (1995 BCSC):***

**Facts:** NBL leased equipment to D, described in the lease agreement as "shelving". The lease was registered in the PPSR. The lease was assigned from NBL to GE. D made an assignment in bankruptcy subsequently.

The goods in this case are equipment. S. 10 requires that a security agreement contain a description of the collateral by item or kind

**Issue:** Whether the description "shelving" complies w/ s. 10 of the PPSA, such that the SA is enforceable against a third party?

**Held:** GE's security agreement is valid against D b/c the word "shelving" was sufficient to describe the collateral in the agreement per s. 10.

**Ratio:** Per s. 10, the description of collateral will be satisfied by identification of the item or kind, subject to the ban on the words "equipment" or "consumer goods". Particulars sufficient for identification such as make, model, manufacturer serial or part number are not requirements. This does not relieve the secured party of the obligation imposed by s. 18 to identify the collateral in the event a demand is served under that section.

## ATTACHMENT LEGISLATION:

- s. 12(1):** A security interest, including a security interest in the nature of a floating charge, attaches when
- (a) value is given,
  - (b) the debtor has rights in the collateral or power to transfer rights in the collateral to a secured party, and
  - (c) except for the purpose of enforcing rights between the parties to the security agreement, the security interest becomes enforceable within the meaning of s. 10,
- unless the parties specifically agree in writing to postpone the time for attachment, in which case the security interest attaches at the time specified in the agreement
- s. 12(2):** for the purposes of subsection (1)(b) and without limiting other rights that the debtor may have in the collateral, a debtor has rights in goods leased to the debtor or consigned to the debtor when the debtor obtains possession of them in accordance with the lease or consignment
- s. 12(3):** For the purposes of subsection (1), a debtor has no rights in
- (a) crops until they become growing crops,
  - (b) the young of animals until they are conceived,
  - (c) minerals until they are extracted, and
  - (d) trees other than crops until they are severed
- s. 12(4):** the attachment of a security interest in a securities account is also attachment of a security interest in the security entitlements carried in the securities account
- s. 12(5):** the attachment of a security interest in a futures account is also attachment of a security interest in the futures contracts carried in the futures account.
- s. 13(1):** Except as provided in subsection (2), where a security agreement provides for a security interest in after-acquired property, the security interest attaches in accordance with s. 12, without the need for specific appropriation
- s. 13(2):** a security interest does not attach to the after-acquired property that is
- (a) a crop that becomes a growing crop more than one year after the security agreement has been entered into, except that a security interest in crops that is given in conjunction with a lease, agreement for sale or mortgage of land may, if so agreed, attach to crops to be grown on the land concerned during the term of the lease, agreement for sale or mortgage, or
  - (b) consumer goods, other than an accession, unless the security interest is a purchase money security interest or a security interest in collateral obtained by the debtor as replacement for collateral described in the security agreement
- New tire put on a truck**  
**Security interest over a computer that attaches to a replacement computer if that one breaks—if agreement provides for security interest in replacement goods then that will be given compliance**
- s. 14(1):** A security agreement may provide for future advances (aka “all obligations clause”, “money clause”)
- s. 14(2):** Unless the parties otherwise agree, an obligation owing to a debtor to make future advances is not binding on a secured party if, pursuant to s. 35(6), the security interest does not have priority over a writ of enforcement with respect to those future advances.

**Attachment:** the time when the security interest comes into existence

- If the security interest has not attached to an item of the debtor’s property, the creditor remains an unsecured creditor in relation to it
- A security interest attaches when:
  - (a) value is given
    - **Value:** any consideration sufficient to support a simple contract and includes an antecedent debt or liability
    - Past consideration is sufficient
      - **Unsecured loan is created and you later decide to secure the loan and ask the debtor if they would be willing to create a security interest; if the debtor agrees, you can sign a security agreement: the past unsecured loan is an antecedent loan for liability and don’t need fresh consideration**
  - (b) the debtor has rights in the collateral; and
    - **Rights in Collateral:** the debtor must have some proprietary interest in the collateral before the security interest can attach to it

- (c) the writing requirements of a security agreement have been met (in the case of a non-possessory security interest)
  - only applies when dealing with a dispute between the secured party and some third party
- **Creditor advances funds (loans the money) then the security agreement is executed later (assuming s. 10 requirements have been satisfied), then an additional interest is acquired and the clause stipulated in the SA “all present and after acquired personal property”. When does the security interest attach?**
  - Apply s. 12:
    - Value is given when the funds are advanced
    - S. 10 requirements are met when the SA is executed
    - The debtor has rights in collateral when they acquire them (not specified)
  - The attachment to the existing assets occurs at the day the security agreement is executed
  - In respect to new assets acquired, they are attached at the time they are acquired in the future
- **s. 14** permits the parties to create a security interest that secures later advances if that is their intention; it does not itself create a right to secure future advances. Rather, it permits the use of future advances or all monies clauses.

## CASE LAW:

### ***Sprung Instant Structures Ltd v Caswan Environmental Services Inc (1997 ABQB):***

**Facts:** S leased two portable tent-like structures to C for a lease term of 24 months, that was extended by 7 months. C was to pay S \$10,813/month during the term of the lease. RBC advanced funds to C under the terms of a GSA, this interest was registered. S subsequently registered. C declared bankruptcy. S and RBC claim a right to the structure.

S claims that RBC’s GSA did not give RBC a security interest in the structure—C only gave RBC a security interest in property *owned* by C and therefore, the security interest could not attach to the structure b/c C did not own it.

**Issue:** Does the GSA executed between C and RBC grant RBC a security interest in the structure? Between RBC and S whose interest has priority? If RBC has a security interest in the structure, does S’s seizure of the structure affect RBC’s security interest? Is RBC estopped from denying S’s right to full possession and ownership of the structure?

**Held:** The granting clause to RBC “in all of [C’s] present and after acquired personal property including, without limitation” is clear that ownership of the personal property is not required before a security interest will attach. This clause includes the structure.

RBC has priority to the structure over S’s interest b/c RBC registered first: RBC perfected its security interest by registration on December 30, 1994. S initially had a purchase-money security interest w/ the potential for “super priority” over RBC’s security interest from the date of C’s possession (around August/September 1994), however this was never realized as S perfected its security interest by registration on May 25, 1996, well outside the 15-day grace period allowed by the Act.

Seizure or repossession does not perfect a security interest as per s. 24(1)

**Ratio: A purchase-money security interest will have “super priority” over an “all present and after acquired” granting clause where it is registered within the 15-day period granted by the Act.**

**Court of Appeal:** S’s claim for declaration of valid seizure is allowed—S had priority b/c the granting clause in RBC’s GSA does not apply to leases.

Note: NZLR in 2004, and NZCA in 2005 shut down the ABCA’s interpretation of *Sprung*, opting to follow the trial judge’s reasoning’s.

***i Trade Finance Inc v Bank of Montreal (2011 SCC):***

**Facts:** i Trade advanced funds to W, under a fraudulent scheme perpetuated by the president of W, Mr. A. Mr. A used the money advanced to W to purchase shares with BMO. BMO had no knowledge of the fraudulent scheme or that the funds used to purchase the shares had originated from that scheme. Judge B ordered, on consent of all parties, that Mr. A's shares be sold and the proceeds of sale be put in trust pending further order of the court. It is the allocation of this money that is in dispute. i Trade argues that it advanced the funds to W under a mistake of fact and accordingly has a *prima facie* right to recover them and that BMO could acquire an enforceable security interest only if the pledgors themselves had rights in the collateral to pledge to BMO—Ms A had no interest b/c she had given no consideration upon the purchase of the shares and Mr. A procured the shares by fraud.

BMO argues that when I Trade loaned the money to W, I Trade intended to pass title in the money to W, regardless of the fact that it was induced to do so by fraudulent misrepresentations. Furthermore, the dispute is not governed by the PPSA b/c the pledge agreement establishes that BMO is a *bona fide* purchaser for value without notice and this shields them from I Trade's claim to the disputed funds.

**Issue:** Is BMO a *bona fide* purchaser for value without notice? (if BMO is such a purchaser, i Trade's claim to the disputed funds cannot succeed)

The nature of i Trade's interest in the disputed funds?

The nature of BMO's interest in them?

Whether the debtors (Mr A and his wife) had a right in the shares sufficient to support granting BMO a security interest?

**Held:** Nature of I Trade's interest: I Trade's claim to the disputed funds arises from the judgment of Judge B, giving it an equitable proprietary interest in the shares credited to the investment account and this interest is not governed by the PPSA.

Nature of BMO's interest: *Canadian Imperial Bank of Commerce* says that when an innocent party consensually advances funds to another under an agreement, it voluntarily parts with those funds and this divestiture conveys the right to use them. Before I Trade discovered the fraud and initiated civil proceedings, W had I Trade's consent under the agreements to use the money advanced by I Trade. W was entitled to use the funds. Mr A and Ms A were able to acquire "rights" in the shares using the proceeds of the paycheques and of the corporate loans. As a result they had "rights" in the collateral that were sufficient for them to pledge the shares to BMO and thereby create a security interest. BMO's interest in the shares credited to the investment account could therefore attach, giving it an enforceable PPSA security interest.

The statutory security interest created by the PPSA defeats the common law pledge. Therefore, if BMO is found to be a "bona fide purchaser for value without notice of a pre-existing equitable interest", I Trade's equitable proprietary right will be defeated by the transaction in which BMO acquired its statutory security interest. BMO is a bona fide purchaser for value without notice and b/c I Trade's interest is defeated by this, I Trade cannot succeed.

**Ratio: Where a "bona fide purchaser for value without notice of a pre-existing equitable interest" holds a security interest, the bona fide purchaser will beat out other equitable proprietary interest holders who do not have security interests.**

***Eagle Investments Inc v CPC Networks (2012 SKCA):***

**Facts:** CPC grants a GSA to Bank of Canada and gets \$150,000. Eagle Eye loans CPC \$465,556 on an unsecured basis. Black Dove buys on Bank of Canada and pays out the unpaid interest of the loan and assigns the security interest to Eagle Eye. Eagle Eye wanted the all obligations clause in the SA to "cover all obligations" so believed their \$465,556 was secured as well as a result of that clause.

**Issue:** Whether an "all obligations" clause, contained in an assigned security agreement, can secure the previously unsecured debts owing by the debtor to the assignee from a time before the assignment took place?

**Ratio: Matter of contract interpretation: to determine what the presence of an "all obligations" clause means in any given circumstance, must first interpret the GSA and Letter of Offer to determine whether the original contracting parties intended the assignment clause to secure the unsecured debts of a future assignee. If the parties did so intend, then determine whether a commercially defensible reason exists preventing the GSA from operating in that matter.**

## EXAMPLES:

- 1) Grinder Enterprises Ltd agrees to give the Regal Bank a security interest in Grinder's drill press. Grinder executes an agreement that gives to the Regal Bank a security interest in all of Grinder's assets listed in Schedule A. Due to an unfortunate oversight, the Regal Bank neglects to complete schedule A and leaves it blank. The Regal Bank is able to produce an unsigned memorandum sent to it by the chief executive officer of Grinder prior to the execution of the security agreement in which Grinder provides a serial number description of the drill press, and which clearly shows that Grinder intended to grant a security interest in it. Grinder subsequently goes bankrupt and the trustee in bankruptcy claims that the security interest claimed by Regal Bank is not enforceable against it. The chief executive officer is also prepared to testify that he intended to give the bank a security interest in all of Grinder's property. How should this dispute be resolved?
  - Dealing with s. 10 enforceability requirements:
    - Either the SP has to have possession (possessory security interest)—not the case here—or written security agreement
      - SA signed by debtor with qualifying collateral description, which is missing here
        - Does not matter the debtor intended to do this, the idea is that the third party should be able to rely on tangible written evidence on the relationship between the secured party and the debtor in order to be enforceable
        - Unless some incorporation by reference in another document, it won't work
          - if the SA said: another document mentions the description and the other document is included
- 2) A security agreement contains the following collateral description in the charging provisions: "The debtor grants to the Secured Party a security interest in all present and after acquired refrigerator and ovens located in the apartment building located at 3458 Florence Ave, Edmonton, Alberta". Does this satisfy the enforceability requirement in s. 10 of PPSA? What would be the outcome if a refrigerator were taken from the premises and relocated at some other apartment building?
  - It does comply (according to Prof)
    - Look at underlying policy/interpretive approach that courts take in looking at the PPSA: its about facilitating the intentions of the parties so allow them to reach commercial sensible arrangements
    - In many cases apartment buildings are separately financed, so makes sense to restrict the collateral description to one specific location
    - *Dicks* case
  - Description by kind in which the location is part of the description is okay
  - Same thing with supplier restrictions: "all goods supplied by "X Supplier""—supplier qualification narrowing the security interests
    - No commercial reason not to permit that
- 3) On January 11, 2009, D signed a security agreement that gave SP a security interest on all of D's present and after-acquired personal property. On January 12, 2009, SP registered a financing statement at the PPR that correctly identified the debtor name and that described the collateral as all present and after-acquired personal property. They had not yet concluded a loan agreement that they were negotiating. On Jan 15, 2009, D sold a metalworking lathes to B. On January 20, 2009, the loan agreement was concluded and SP advanced \$10,000 to D. D has since defaulted on the loan and a priority competition has arisen between SP and B in respect of the lathes. Who has the better claim to it?
  - If no attachment, we are saying the creditor does not have a security interest so when the debtor sells it, the debtor has full and unencumbered right to sell
  - This is not the case of an unperfected security interest, this is a case of no attachment so NO security interest: there is perfection step and registration step but no attachment so no security interest

# CHAPTER FIVE: PERFECTION

## LEGISLATION:

**s. 19:** A security interest is perfected when

- (a) it has attached, and
- (b) all steps required for perfection under this Act have been completed

regardless of the order of occurrence

**s. 20:** A security interest

- (a) in collateral is not effective against
  - (i) a trustee in bankruptcy if the security interest is unperfected at the date of bankruptcy;
- (b) in goods, chattel paper, a negotiable document of title, an instrument, an intangible or money is subordinate to the interest of a transferee who
  - (i) acquires the interest under a transaction that is not a security agreement,
  - (ii) gives value, and
  - (iii) acquires the interest without knowledge of the security interest and before the security interest is perfected

**s. 24(1):** subject to s. 19, possession of the collateral by the secured party, or on the secured party's behalf of another person, perfects a security interest in

- (a) goods,
- (b) chattel paper,
- (d) a negotiable document of title,
- (e) an instrument, and
- (f) money

but only while it is held as collateral and not while it is held as a result of a seizure or repossession

**s. 24(2):** a secured party does not have possession of collateral that is in the actual or apparent possession or control of the debtor or the debtor's agent

**s. 25:** subject to s. 19, registration of a financing statement perfects a security interest in collateral.

**s. 26:** A security interest perfected under s. 24 in

...

remains perfected for the first 15 days after the collateral comes under the control over the debtor

**s. 35:** Where this Act provides no other method for determining priority between security interests,

(a) priority between perfected security interests in the same collateral is determined by the order of occurrence of the following:

- (i) registration of a financing statement without regard to the date of attachment of the security interest,
- (ii) possession of the collateral under s. 24, without regard to the date of attachment of the security interest, or
- (iii) perfection under s. 5, 7, 26, 29 or 77

whichever is earlier

(b) a perfected security interest has priority over an unperfected security interest, and

(c) priority between unperfected security interests is determined by the order of attachment of the security interests

**Perfection:** used to describe certain protective measures that are taken by a secured party in order to give public notice that a security interest is taken in the collateral

- Perfected: if the protective step is completed the security interest is perfected
- Unperfected: if the protective step is not completed, the security interest is unperfected
  - Remains valid as between the secured party and the debtor but generally ineffective against certain third parties
- Rationale: b/c a security agreement has the potential to adversely affect the rights of third parties who are not privy to the security agreement

## Methods of Perfection:

### 1) Perfection by Possession (s. 24)

- Security interest may be perfected by the taking of possession of the collateral by the secured party during the course of the financing relationship
  - Not satisfied if the collateral is in the actual or apparent possession or control of the debtor or the debtor's agent
  - Only effective so long as the secured party or the agent of the secured party maintains possession of the collateral

- Does NOT apply to intangibles
  - **NOTE: Perfection by Repossession is NOT a recognized perfection step:**
    - b/c:
      - 1) desire to achieve predictable outcomes, would tend to make it more difficult to determine priorities
      - 2) law should not create an incentive that would induce a secured party to exercise an enforcement remedy for an ulterior motive
- 2) Perfection by Registration (s. 25)**
- through registration of a document called a financing statement
  - universally applied to all types of collateral
  - most commonly used form
- 3) Temporary Perfection (s. 26)**
- Perfection allowed for a short period of time to allow the secured party an opportunity to perfect by possession or registration
- 4) Perfection by Control (for Investment Property ONLY)**
- Occurs when the secured party is in a position where it is able to sell the investment property without the need for any further action by the debtor
    - Certified Security: by taking delivery of the certificate
      - For registered certificate, need endorsement of the registered owner on the certificate
    - Uncertified Security:
      - 1) secured party or agent registered as owner on issuer's share register; or
      - 2) entering into a control agreement
        - Control Agreement:
          - Tripartite agreements among the secured party, the debtor, and intermediary under which the intermediary agrees to comply with the instructions of the secured party without further consent of the debtor
    - Security Entitlement:
      - 1) having the SP registered as the entitlement holder;
      - 2) by entering into control agreement; or
      - 3) having a third party obtain control of the security entitlement as the secured party's agent

#### Timing of Perfection:

- Can occur before or after a security attaches
  - If before:
    - The security interest with attain perfected status the moment it comes into existence (attaches)
  - If after:
    - There will be a period of time during which the security interest is attached but unperfected
- Secured Party vs Unperfected Secured Party:
  - Secured party wins
- Secured Party vs Secured Party:
  - Secured party who perfected first wins
- Unperfected Secured Party vs Writ of Enforcement Party:
  - Writ of enforcement party
    - **Civil Enforcement Act s. 35:** a security interest is subordinate to a writ that binds personal property unless the secured party has completed a perfection step prior to the writ's binding effect (when the writ is registered)
      - It is not a requirement that the security interest be perfected at this point; if the step has been taken, attachment can occur after the registration of the writ of enforcement
- Unperfected Security Interest vs Trustee in Bankruptcy (s. 20):
  - trustee in bankruptcy when the security interest is not perfected at the time of bankruptcy
    - **Time of Bankruptcy:**
      - Voluntary Bankruptcy (instituted by the debtor through the filing of an assignment in bankruptcy):
        - When the assignment was made
      - Involuntary Bankruptcy (initiated by the creditor who files a petition for a receiving order):
        - When a bankruptcy court makes a receiving order
          - NOT when the initial petition for receiving order is filed by a creditor

- Why do we give priority to the trustee in bankruptcy?
  - B/c the trustee is a representative of the unsecured creditors and when there is a bankruptcy the unsecured creditors are prevented from enforcing their rights against the debtor's property/assets w/out a stay of proceedings

## CASE LAW:

### *Re Giffen (1998 SCC):*

**Facts:** TLC leased a car to BC Telephone Company, which in turn leased the car to one of its employees, G. The term of the lease was for more than one year. The lease gave the bankrupt the option of purchasing the vehicle from TLC. Neither the lessor or BC TC registered financing statements in respect of their leases. G went bankrupt. TLC seized the vehicle and sold it with the trustee's consent. The trustee subsequently brought a motion for an order that it was entitled to the proceeds of sale relying on s. 20(b)(i) of PPSA.

**Issue:** whether s. 20(b)(i) of the PPSA can render a lessor's unperfected security interest in personal property ineffective against the rights acquired in the property by the trustee in bankruptcy?

**Held:** s. 20(b)(i) defeats the unperfected security interest of TLC (the lessor) in favor of the interest acquired by RW&A (the trustee).

**Ratio:** An unperfected security interest will be ineffective against a trustee in bankruptcy.

## EXAMPLES:

- 1) Suzette Quain operated a cattle ranch in Longview, Alberta. On February 13, 2008 S made an appointment with a loans officer at the Cowtown Industrial Bank of Credit (CIBC) to discuss a loan. On February 14, 2008, CIBC registered a financing statement in the PPR. The financing statement properly recorded Suzette Quain's name and described the collateral as "all present and after acquired personal property". On February 20, 2008, S signed a security agreement under which she granted CIBC a security interest in "all present and after acquired property". On Feb 22, 2008, the loan was approved and CIBC made a binding commitment to make the loan to S. On March 1, 2008.....
  - Starting point: s. 9
    - Tells you when attachment has occurred and when perfection has occurred
  - Then s. 12 (which incorporates s. 10) and look to see if attachment has occurred
  - The registration is the perfection step on February 14, 2008 (but not perfection b/c perfection step + attachment must occur to equal perfection per s. 19)
  - S. 12 requirements:
    - Value has been given
      - Binding promise to grant credit satisfies the value requirement on Feb 22, 2008
    - Perfection occurs: the 200 head of cattle occurs prior to the buying of the 50 so Feb 22, 2008 satisfies the 200
    - March 25 is the perfection of the 50 head of cattle that are subsequently purchased

## CHAPTER 6: REGISTRATION

### LEGISLATION:

- s. 18(1):** The debtor, a creditor, a civil enforcement agency, or a person with an interest in personal property of the debtor, or an authorized representative of any of them may, by a demand in writing ....one ore more of the following:
- (a) a copy of any security agreement
  - (b) a statement of the amount of the indebtedness and the terms of payment
  - (c) approval or correction of an itemized list of the collateral
  - (d) the amount of indebtedness at the time of the request
  - (e) information as to the location of the security agreement
- s. 18(5):** The secured party shall comply with a demand not later than
- (a) 25 days after the secured party receives it, where the secured party is a trustee under a trust indenture, or
  - (b) 10 days after the secured party receives it, in the case of any other secured party
- s. 18(6):** if, without reasonable excuse, the secured party fails to comply, or the reply is incomplete or incorrect, the person making the demand may apply to the Court for an order requiring the secured party to comply with the demand
- s. 35(1):** Where this Act provides no other method for determining priority between security interests,
- (a) priority between perfected security interests in the same collateral is determined by the order of occurrence of the following:
    - (i) registration of a financing statement without regard to the date of attachment of the security interest,
    - (ii) possession of the collateral under s. 24, without regard to the date of attachment of the security interest, or
    - (iii) perfection under s. 5, 7, 26, 29 or 77whichever is earlier
  - (b) a perfected security interest has priority over an unperfected security interest, and
  - (c) priority between unperfected security interests is determined by the order of attachment of the security interests
- s. 35(3):** where the goods are serial number goods, one looks to the first registration giving serial numbers, not to the first registration
- s. 35(4):** a security interest in goods that are equipment and are of a kind prescribed by the regulations as serial number goods is not registered or perfected by registration unless a financing statement relating to the security interest and containing a description of the goods by serial number is registered
- s. 43(1):** A financing statement may be submitted for registration at an office of the Registry specified by the Minister
- s. 43(2):** Registration of a financing statement is effective from the time assigned to it by the Registrar
- s. 43(4):** A financing statement may be registered before a security agreement is made and before a security interest attaches
- s. 43(5):** A registration may relate to one or more than one security agreement
- s. 43(6):** the validity of the registration of a financing statement is not affected by a defect, irregularity, omission or error in the financing statement or in the registration of it unless the defect, irregularity, omission or error is seriously misleading
- s. 43(7):** where one or more debtors are required to be disclosed in a financing statement or where collateral is consumer goods of a kind that is prescribed by the regulations as a serial number goods, and there is a seriously misleading defect, irregularity, omission or error in
- (a) the disclosure of any debtor, other than a debtor who does not own or have rights in the collateral, or
  - (b) the serial number of the collateral,
- the registration is invalid
- s. 43(8):** Does not require, as a condition to a finding that a defect, irregularity, omission or error is seriously misleading, proof that anyone was actually misled by it
- s. 43(9):** Failure to provide a description in a financing statement in relation to any item or kind of collateral does not affect the validity of the registration w/ respect to other collateral
- s. 44(1):** a registration under this Act is effective for the period of time indicated on the financing statement by which the registration is effected
- s. 44(2):** a registration may be renewed by registering a financing change statement at any time before the period registration expires
- s. 44(3):** an amendment to a registration may be made by registering a financing change statement at any time during the period that the registration is effective and the amendment is effective from the date the financing change statement is registered to the expiry of the registration being amended

s. 50(b) of the Personal Property Regulations: allows the Registrar to reply to a search by giving information “corresponding to search criteria similar to those” requested.

## REGISTRATION:

**Registration:** Two basic kinds of registry systems:

### 1) Document Filing Systems

- SA is filed at the Registry

### 2) Notice Registration Systems

- Document that contains details about the SA is registered in the public registry
- **Contents:**
  - **1) Registration Life**
    - from 1-25 years in duration or indefinite
    - fee increases w/ the number of years' chosen
      - provides incentive to parties to choose appropriate registration terms, enhancing the quality of info in the registry by limiting stale registrations
  - **2) Name and Address of Debtor**
    - birthdate of debtor can also be included, but not required
    - **s. 20(2):**
      - last name, followed by first name and middle name, if any (for individuals);
      - corporate name (for corporations)
        - corporate name to be used rather than trade name
  - **3) Name and Address of Secured Party**
  - **4) Description of Collateral**
    - **Serial Number Goods:**
      - Despite many goods having serial numbers, not all goods are serial number goods
      - **ONLY:**
        - Motor vehicle
        - Trailer
        - Mobile home
        - Aircraft
        - Boat
        - Outboard motor for a boat
        - \*Only when held as CONSUMER goods
      - Consumer Goods: Mandatory
      - Equipment: Optional/Recommended
      - Inventory: Optional/Inadvisable
        - Inventory turns over all the time and acquiring new inventory so in terms of administrative burden that would be necessary to keep this up, it would be very large
    - **General Collateral Description:**
      - 1) Item
      - 2) Kind
      - 3) “All present and after acquired personal property”
      - 4) “All present and after-acquired personal property except [ ]”
- **Features:**
  - **Access to Information: (s. 18)**
    - SA is not at the PPR, however, interested parties can obtain details of the SA
      - Copy of the SA
      - Statement of indebtedness and terms of payment
      - Itemized list of the personal property being used as collateral
      - Etc.
  - **Pre-Registration of Financing Statements (s. 43(4))**
    - funds may be advanced to the debtor as soon as the SA is executed—rather than having to wait until a search result reveals the priority status
    - Why allow pre registration?
      - Expedites the closing of a transaction

- Before: you would have to draft→execute→file in registry→search to ensure it was done properly→advance funds
  - Now: able to register in advance and see that registration is effective, the moment the documents are drafted and executed, the funds can be advanced so more efficient
- **Priority** is given to the secured party who registers first
  - **Rule:** first to register beats out subsequent registrations/attachment/perfections
    - **SP1 registers, then SP2 registers, then SP2 perfects/attaches, then SP1 perfects. Who has priority?**
      - **SP1**
- **Blanket registrations (s. 43(5))**
  - A single registration may protect any number of successive security agreements w/ no need to make fresh registration upon execution of a new security agreement, as long as the collateral is contemplated in the granting clause
- **Preventing Abuse of the System:**
  - Potentials for abuse:
    - By including an over-reaching collateral description in a financing statement
    - By maintaining a registration after it is clear that there is no reasonable expectation that the debtor will execute a security agreement in favor of the secured party
    - By maintaining a registration after the obligation secured by the security agreement has been discharged
  - Remedies: **s. 50**
    - potential lender may refuse to extend credit
    - potential lender may negotiate a subordination agreement under which the secured party surrenders some or all of the priority it would otherwise enjoy
    - the debtor or another SP may make a written demand requiring the discharge or amendment of a financing statement
    - debtor may bring an action against the SP and obtain damages caused by SP's failure to comply with a demand for the discharge or amendment of a financing statement
- **Amendments to Registration: (s. 44)**
  - financing change statement can be used to amend registration or to renew a registration by extending its registration life
  - must be registered before the initial registration lapses
  - amendment is only effective from the date that it was made

## ERRORS IN REGISTRATION:

### Test for Invalidating Errors:

- **s. 43(6):** a defect, irregularity, omission or error does not invalidate the registration unless it is *seriously misleading*
- **s. 43(8):** “seriously misleading” test= objective: whether the error was one that would be seriously misleading to a reasonable user of the registry system?
  - not necessary to show that competing claimant was actually misled

### Errors in Search Criteria:

- Where the error in the debtor name or serial number is of a minor nature such that a reasonable searching party would think it was the same debtor or the same serial number good, the registration will not be seriously misleading
- Where the search discloses the registration as an inexact match, it will only be valid if a court concludes that a reasonable searching party would not think that a different debtor was involved
- Where the error in the debtor name does not disclose the registration, the defect will invalidate the registration

### Dual Search Criteria:

- **Serial Number Goods:**
  - **S. 43(7):** both the debtor name AND serial name must be free from seriously misleading errors

### Errors in Non-Searchable Fields:

- TEST: whether a reasonable person reviewing the search result would find it seriously misleading?
  - Error in secured party name or address
    - Typically not invalidate, unless so misleading that a search party would be unable to identify the secured party
  - Error in general collateral description

- Registration remains valid for any collateral that is properly described (s. 43.9)

## CASE LAW:

### ***Case Power & Equipment v 36651 Alberta Inc (Receiver of) (ABCA):***

**Facts:** #Corp (debtor) entered into an SA with Case (creditor). First Calgary (creditor) entered into SA with Case as well. Four different pieces of earthmoving equipment in issue, which are serial number goods.

Load and Rammer:

C registers w/ correct serial number and description, wrong debtor name, then FC registers name w/ no description, no serial number → C amends correcting debtor name → FC amends to include serial number/description

Dozer:

C registers w/ incorrect serial number, description, w/ wrong debtor name → FC registers name w/ no description/serial number → C amends debtor name but not serial number

11 character serial number was wrong by 1 letter

Case Excavator:

C registers w/ wrong debtor name, correct serial number

**Issue:** What secured creditor has priority when there are errors in registration?

**Held:** Loader/Rammer: C has priority per s. 35; Dozer: C has priority, 1 wrong character in serial number is not “seriously misleading”;

Excavator: C’s registration fails b/c errors seriously misleading so FC has priority.

**Ratio:** “**Seriously misleading**” occurs where: (1) it would likely prevent a reasonable search under a reasonable filing or registration system from disclosing the existence of the registration, and (2) it would make a person who did somehow become aware of the registration think that it was likely not the same chattel.

### ***Stevenson v GMAC Leaseco Ltd (2003 NBCA):***

**Facts:** Debtor purchased truck from a local dealer under a purchase and financing agreement that was assigned to GMAC. The inclusion of a serial number was optional in this case. The serial number included was accurate, the debtor’s name was not (“Motorhome”, instead of “Motor Home”). Debtor filed for bankruptcy. GMAC submitted a Proof of Claim to S, the trustee in bankruptcy, claiming a security interest in the truck. S performed a registry search using the debtor’s correct legal name and the search did not reveal GMAC’s interest in the truck either as an exact or close match.

**Issue:** Whether, when a debtor name and a serial number are included, a dual search requirement is imposed?

**Held:** GMAC’s interest is inferior to S’s.

**Ratio:** Debtor name must be free from seriously misleading error and will not be saved by a correct serial number.

**Note:** Had the search of the Registry revealed “Moncton Motor Home & Trailer Sales Ltd” and “Moncton Motorhome & Trailer Sales Ltd”, any reasonable party would have concluded that the inexact match was close enough, however, step 1 of the *Case Power* test was not met so invalid.

**Note:** In BC and Ontario: a seriously misleading error in debtor name will be saved by a correct serial number but not vice versa.

### ***Harder (Trustee of) v Alberta Treasury Branches (2004 ABQB):***

**Facts:** Creditor had a security agreement with debtor for holiday trailer. Creditor registered the SA under an incorrect serial number (16/17 #'s correct). Debtor went bankrupt. Bankruptcy trustee was informed by debtor that holiday trailer had a security interest. Trustee also conducted a registry search with Creditor’s name and did not discover the SA as an inexact or exact match. Holiday trailer falls within definition of “serial number goods”.

**Issue:** Was Creditor’s registration under an incorrect serial number “seriously misleading” such that H’s knowledge but lack of search result invalidates the interest of C?

**Held:** A’s registration is not seriously misleading. A’s registration has priority over C—doesn’t meet the 1<sup>st</sup> test in *Case* but meets the 2<sup>nd</sup> test b/c they had actual knowledge.

**Ratio:** A secured creditor who makes an error in the serial number is not defeated by a subsequent secured creditor or bankruptcy trustee when the subsequent party obtained actual knowledge of the existence of the security as a result of the name search of the debtor, or through communication with the vendor/borrower about the existence of the security agreement, or otherwise.

**Note:** Problem b/c the court is applying a knowledge based test as the test for seriously misleading error when s. 43(8) states that it doesn’t matter if a person had actual knowledge.

### ***John Deere Credit Inc v Standard Oilfield Services Inc (2000 ABQB):***

**Facts:** S was originally incorporated as #’d Corp, but always operated under S name. Deermart leased to S a piece of equipment that was assigned to JDC and registered (Agreement 1). A second piece of equipment was leased by D to S, assigned and registered to JDC (Agreement 2). Later, S told D they could not pay these agreements and they were paid off and refinanced into Agreement 3, which

was registered under JDC even though they refused to finance the indebtedness. RBC registered against all present and after acquired personal property of S. Then Agreement 3 was amended to name D as the creditor.

**Issue:** Whether JDC's security interest was unperfected b/c of errors in registration at the PPR? Does D or JDC have priority security interest under Agreement 3 given that the secured party was initially registered as JDC and not D and there was no valid assignment from D to JDC and JDC had been paid in full for Agreement 1 and 2?

**Held:** RBC had priority interest over JDC/D b/c at the time of RBC's registry, Agreement 3 was unperfected due to errors in registration that were not amended until after the date of RBC's registry.

**Ratio:** An error in the secured party's information on a financing statement such that a searching party would be unable to reasonably identify the secured party will be invalid as a seriously misleading error.

***Service Foods Manawatu Ltd (Receivers) v NZARFD (2006 NZCA):***

**Facts:** The description of the collateral in the SA: "Goods supplied by NZARFD to the buyer". The description of Collateral in Financing statement was "all present and after-acquired property". Therefore, financing statement claimed more than the SP was entitled to.

**Issue:** Does an over inclusive collateral description invalidate a financing statement?

**Held:** An over inclusive collateral description is not a seriously misleading error in registration. Handle through s. 50 and require the SP to amend their financing statement so it only covers what they are entitled to

**Ratio:** An over inclusive collateral description will not qualify as a seriously misleading error in registration.

**Note:** According to Wood, CA Court would arrive at the same conclusion.

## EXAMPLES:

- 1) Lotgar Holdings Ltd executed a general security agreement in favour of the Cowtown Bank of Credit on May 30, 2008 to secure an operating line of credit. The security agreement gave CBC a security interest in all "present and after-acquired personal property" of the debtor. On June 2, 2008 CBC registered...
  - a. Will cover after Midterm
  - b. Assume that Lotgar did not change its name. Supposed instead that Whiteline Truck Sales Ltd sold a new truck to L on July 23, 2009 under a secured instalment sales agreement and on that same day it registered a financing statement that correctly recorded its serial number in the serial number field
  - A correct serial number does not correct a seriously and misleading error in debtor name so trustee has priority over W
  - If held as equipment, it is advisable to register with a serial number to beat out buyer without knowledge or another registration of equipment—however, this has a priority over trustees in bankruptcy if registered with the serial number (only beat out by buyer without knowledge or buyers who have registered serial number in the equipment before you)

# REVIEW QUESTIONS FOR MIDTERM

- 1) Indicate the extent to which the PPSA applies to the following transaction:
  - A factoring company agrees to purchase the accounts receivable of a business without recourse, so that the risk of non-payment is borne by the factoring company.
  - Deemed security interest so all of the PPSA applies, except s. 5
    - Someone is purchasing an asset, its an absolute transfer (not by way of security), nevertheless, transfers of accounts are caught by the PPSA per 3(2).
- 2) Great White North Galleries Ltd owns several art galleries across Canada, including one in Edmonton and one in Vancouver. Its CE office is in Vancouver. It has given a security interest covering all of its present and after-acquired personal property to Regal Bank. Where must the Regal Bank register in order to perfect its security interest in the paintings located in the Edmonton gallery?
  - Alberta
    - Dealing with conflicts rule; the major rule is s. 5/s.7
    - S. 5 is the rule that covers most goods—collateral location at the time the security interest attaches so if paintings are located in Alberta, that's where you need to register
    - S. 7 applies to intangibles, mobile equipment, held as equipment or leased inventory, and non-possessory security interests, apply where debtor is located
      - But s. 7 doesn't apply in this case
- 3) A customer from Saskatchewan has a large account owing for paintings purchased from the Edmonton gallery. Where must the Regal Bank register in order to perfect its security interest in this account?
  - British Columbia
  - Applying s. 7: account is an intangible so go to location of the debtor
  - The debtor under the security agreement is Great White North Galleries b/c registering against debtor, not the customer. The gallery has a valuable right of payment and that's what it is giving as collateral and we use location of the gallery as the debtor and b/c the chief executive office is in Vancouver so that's where we use
- 4) Ten paintings located in the Edmonton gallery are later shipped to the Vancouver gallery. Prior to this, the Regal Bank had registered its security interest in Alberta. What must the Regal Bank do in order to maintain the perfected status of its security interest in the paintings?
  - Register in BC not later than 15 days after learning of the relocation
    - S. 5/s. 7 have rule regarding both of these: one of these is relocation of the debtor, the other is relocation of the goods
      - So if you don't know about relocation, registration will become ineffective after 60 days; if you do know about relocation, registration will become ineffective after 15 days
- 5) D signs a very short written security agreement which provides simply that "As consideration for a loan of \$5000, D grants to SP a security interest in all of D's goods". D signs the security agreement. One year later, SP makes a further loan of \$10,000 to D. SP's security interest secures:
  - Only the initial loan of \$5000
    - The SA is limiting itself to only the first loan
    - If it included an All Obligations Clause it would have secured the subsequent loans
    - S. 14 doesn't give you the right to future obligations, only gives you the right if the SA mentions it
- 6) What would be the outcome in a competition with a third party if the debtor signed a security agreement which described the collateral as "all present and after acquired equipment and chattel paper"?
  - The security interest would be effective against the chattel paper, but not the equipment
    - b/c "equipment" is not a satisfactory description of collateral per s. 10(3), without more of a description regarding the debtor's use of the collateral
- 7) SP is given a security interest in D's automobile that is used by D for personal and family use. On May 25, SP registers a financing statement that describes the collateral as "motor vehicle" with debtor name correct. On July 10, D defaults and SP enforces the security interest by taking possession of it. SP's security interest is:
  - Not perfected
    - b/c a motor vehicle needs a serial number including in the Financing Statement to be properly registered, therefore, perfection did not occur when registered
    - b/c "perfection by possession cannot occur by seizure" per s. 24
- 8) SP was given a security interest in all of D's present and after acquired personal property on April 5. On April 10, D sold a photocopier to B who did not know of SP's interest. On April 12, several unsecured creditors made an application for a

bankruptcy order. On April 15, SP registered a financing statement. On April 30, the court made a bankruptcy order. How should SP's security interest rank as against B and the trustee in bankruptcy?

- SP loses to B, but has priority over trustee in bankruptcy.
    - S. 20 application: effect of non-perfection
  - An unperfected security interest is subordinate to a bona fide purchaser (buyer without knowledge)
  - An unperfected security interest is subordinate to a trustee in bankruptcy if the Bankruptcy order is applied before the security interest is perfected
    - b/c security interest perfected before bankruptcy order, SP has priority over trustee in bankruptcy
- 9) D gave SP1 security interest in automobile and computer used by D for personal and family use. SP1 registered a financing statement which correctly recorded the serial number of the automobile in the serial number field and described the collateral as "computer" in the general collateral field. The debtor was recorded as "Debra Deckster". This error was such that a search using the correct name did not disclose the registration. However, a search using the serial number would reveal the registration. Two months later, D gave a security interest in the automobile and the computer to SP2. SP2 properly registered a financing statement in the PPR that correctly recorded the debtor name described the automobile by serial number and described the collateral as "goods" in the general collateral field. SP2 has priority over SP1 in respect of:**
- Debtor name is universal requirement—has to be free of seriously and misleading error
    - Apply test in *Case Power*
      - If you search using correct name, it has to at least produce an inexact match
      - If it does come out as inexact match: would the searching party have the eureka moment that it was so close that it was the same person/same chattel
      - So where it does not produce an inexact match= seriously and misleading
  - Both the automobile and the computer
- 10) On Jan 10, D signed a security agreement which gave SP a security interest in D's industrial freezer. On January 15, SP registered a financing statement which correctly recorded the debtor name and described the collateral as "goods". On August 15, D signed a second security agreement which gave SP a security interest in D's high speed printer. On September 29, D went bankrupt. On Sept 30, SP registered a second financing statement which described the collateral as "high speed printer". The trustee in bankruptcy has priority over the SP in respect of:**
- Neither the freezer nor the printer
    - b/c "goods" covers the high speed printer and s. 43(5) specifically states that a financing statement can cover more than one security agreement
    - the second registration is irrelevant b/c the first SA covers the later security interest
  - If the second SA covered "chattel paper" then the description of the original security agreement would not be satisfactory and a financing change statement or a new registration would be required
    - Prof Practice Point: register financing change statement b/c limits the number of registrations of financing statements that exist in the Registry

## CHAPTER SEVEN: COMPETITION WITH BUYERS

### LEGISLATION:

#### Perfection Re Proceeds:

- s. 28(1)(a):** Subject to this Act, where collateral is dealt with or otherwise gives rise to proceeds, the security interest
- (a) continues in the collateral, unless the secured party expressly or impliedly authorized the dealing,
  - (b) extends to the proceeds,

but where the secured party enforces a security interest against both the collateral and the proceeds, the amount secured by the security interest in the collateral and the proceeds is limited to the market value of the collateral at the date of the dealing.

#### Buyer or Lessee Takes Free of Security Interest:

##### s. 30:

- (1)** for the purposes of this section,
- (a)** “buyer of goods” includes a person who obtains vested rights in goods pursuant to a contract to which the person is a party, as a consequence of the goods’ becoming a fixture or accession to property in which the person has an interest;
  - (b)** “ordinary course of business of the seller” includes the supply of goods in the ordinary course of business as part of a contract for services and materials;
  - (c)** “seller” includes a person who supplies goods that become a fixture or accession
    - (i)** under a contract with a buyer of goods, or
    - (ii)** under a contract with a person who is a party to a contract with a buyer of goods.
- (2)** a buyer or lessee of goods sold or leased in the ordinary course of business of the seller or lessor takes free of any perfected or unperfected security interest in the goods given by the seller or lessor or arising under s. 28 or 29, whether or not the buyer or lessee has knowledge of it, unless the buyer or lessee also has knowledge that the sale or lease constitutes a breach of the security agreement under which the security interest was created.
- (3)** a buyer or lessee of goods that are acquired as consumer goods takes free from a perfected or unperfected security interest in the goods if the buyer or lessee
- (a)** gave value for the interest acquired, and
  - (b)** bought or leased the goods without knowledge of the security interest
- (4)** subsection (3) does not apply to a security interest in
- (a)** a fixture, or
  - (b)** goods the purchase price of which exceeds \$1000 or, in the case of a lease, the market value of which exceeds \$1000.
- (5)** a buyer or lessee of goods takes free from a security interest that is temporarily perfected under s. 26, 28(3) or 29(4) or a security interest the perfection of which is continued under s. 26, 28(3) or 29(4) or a security interest the perfection of which is continued under s. 51 during any of the 15-day periods referred to in those sections, if the buyer or lessee
- (a)** gave value for the interest acquired, and
  - (b)** bought or leased the goods without knowledge of the security interest
- (6)** Where goods are sold or leased, the buyer or lessee takes free from any security interest in the goods perfected under s. 25 if
- (a)** the buyer or lessee bought or leased the goods without knowledge of the security interest, and
  - (b)** the goods were not described by serial number in the registration relating to the security interest.
- (7)** subsection (6) applies only to goods that are equipment and are of a kind prescribed by the regulations as serial number goods.
- (8)** a sale or lease under subsections (2), (3), (5), and (6) may be
- (a)** for case,
  - (b)** by exchange for other property, or
  - (c)** on credit,
- and includes delivering goods or a document of title to goods under a pre-existing contract for sale but does not include a transfer as security for, or in total or partial satisfaction of, a money debt or past liability.
- (9)** a purchaser of a security, other than a secured party, who
- (a)** gives value,
  - (b)** does not know that the transaction constitutes a breach of a security agreement granting a security interest in the security to a secured party that does not have control of the security, and
  - (c)** obtains control of the security,
- acquires the security free from the security interest.
- (10)** a purchaser referred to in (9) is not required to determine whether a security interest has been granted in the security or whether the transaction constitutes a breach of a security agreement.

**(11)** an action based on a security agreement creating a security interest in a financial asset, however framed, may not be brought against a person who acquires a security entitlement under s. 95 of the *Securities Transfer Act* for value and did not know that there has been a breach of the security agreement,

**(12)** a person who acquires a security entitlement under s. 95 of the *Securities Transfer Act* is not required to determine whether a security interest has been granted in a financial asset or whether there has been a breach of the security agreement.

**(13)** If an action based on a security agreement creating a security interest in a financial asset could not be brought against an entitlement holder under (11), it may not be asserted against a person who purchases a security entitlement, or an interest in it, from the entitlement holder.

### Proper Exercise of Rights, Duties and Obligations

**s. 66(3):** The principles of common law, equity, and the law merchant, except insofar as they are inconsistent with the provisions of this Act, supplement this Act and continue to apply.

## BUYER PRIORITY RULES:

### BUYER OVER UNPERFECTED SI:

**s. 20(b):** an unperfected SI is subordinate to a buyer who gives value and is without knowledge of the SI.

### BUYER PRIORITY OVER TEMPORARILY PERFECTED SI:

**Relocation under Location of Collateral Rule: s. 5(2):** limited grace period that takes place when collateral caught under s. 5 is transferred into Alberta is not effective against an Albertan buyer who takes without knowledge of SI.

**Instrument or Certified Security Given Back to Buyer by SP: s. 26:** the temporary grace period that takes place when SP gives back an instrument or certified security to the buyer under s. 25 is subordinate to a buyer under s. 30(5)—value and without knowledge.

**Transfer of Debtor's Interest or Debtor Name Change: s. 51:** the temporary grace period afforded under s. 51 is subordinate to buyer under s. 30(5)—value and without knowledge.

### BUYER (AND LESSEE) OVER PERFECTED SI:

**S. 20 of the PPSA:** provides that an unperfected security interest is subordinate to buyer who is without knowledge of the security interest. However, certain kinds of buyers may also take priority over a perfected security interest:

- Sales authorized by the secured party (**s. 28(1)(a)**)
- The ordinary course buyer rule (**s. 30(2)**)
- Sales of lower value consumer goods (**s. 30(3) and (4)**)
- Buyer protection against temporary perfection (**s. 30(5)**)
- The serial number goods rule (**s. 30(6) and (7)**)

These priority rules often overlap; buyer may assert either one or both in claiming priority over the secured party.

Rules apply to both a buyer and a lessee of goods.

**Authorized Sales Rule (s. 28(1)(a)):** where a debtor deals with collateral, the security interest continues in the collateral—concept that the secured party has the right to follow the collateral into the hands of a third party. However, where the secured party authorizes the dealing, the SP cannot claim the collateral from the third party.

- Authorization may be direct or implied
- Need not be in writing
- Authorization to sell must be given *before* the sale (***Landson v Saskatchewan***)
- Some SA's contain authorization provision
  - Difficulty arises where SA contains negative covenant that prohibits the dealing but the course of dealings with the parties shows an implied consent to the transactions
    - Where this occurs: court must determine if there had been a contractual variation or waiver of the negative covenant

**NOTE: Following Rules (s. 30) only cover goods (consumer goods, inventory, equipment).**

**Ordinary Course Buyer Rule (s. 30(2)):** provides that a buyer of goods sold in the ordinary course of business of the seller takes free of a perfected or unperfected security interest given by the seller. It does not matter that the buyer knows of the existence of the security interest, only precluded to claim priority under this section where the buyer knows the sale constitutes a breach of the SA.

- Policy:

- Customers who deal with the debtor in the ordinary course of business should not be subject to the risk that the sale was not authorized by a secured party
- S. 30(2) does NOT apply where it was not the seller, but some other person who granted the security interest.
  - SP takes a security interest in a combine used in D's farming operation. D, without authorization, sold the combine to B1 who operates a new and used farm implement dealership. B1 resells the combine to B2, who acquires it in the ordinary course of B1's business.
    - Although the sale to B2 occurred in the ordinary course of B1's business, the security interest in question was not one that was given by the seller. Rather, it was a former owner (D) who granted the security interest.
    - SP may assert the security interest against the combine in the hands of B2.
  - SP makes consumer loan to B. B gives SP a security interest in B's computer to secure the loan. The SA says: you can't sell to anyone else. B sells the computer to a third party (C). SP perfected the security interest by registration at the time of the sale. B is not in the business of selling computers (not in the ordinary course of business).
    - Per s. 28(1)(a): SP's security interest prevails in the computer, in the hands of the third party buyer. SP has right to assert that interest against C.
  - What if C sells to D. C is in the ordinary course of selling computers. Does D have priority over SP?
    - SP's security interest remains b/c the rule is limited only to the sale between the seller who granted the security interest.

**Buyer of Consumer Goods Rule (s. 30(3) and (4)):** protects buyers of low value consumer goods, where: (1) the goods are acquired by the buyer for personal, family, or household purposes; (2) the value of the goods does not exceed \$1000; and (3) the buyer does not know of the existence of the security interest.

- Note: the goods do NOT need to be bought in the ordinary course of business of the seller (therefore, covers goods bought at garage sale or other private sale by non-commercial seller)
- The buyer takes free of all security interests in the goods, not simply those that have been given by the seller.
- SP takes a security interest in D's mountain bike. D sells the bike to B1 for \$1500. B1 later places an ad in the newspaper and resells the bike to B2 for \$900. B2 did not know of SP's security interest and acquired the bike for personal use.
  - SP's security interest was not lost following the sale to B1 b/c the price exceeded \$1000. Despite that it was an earlier party (D) and not the seller (B1) who gave the security interest to SP, the consumer buyer priority rule applies and B2 takes free of SP's security interest.

**Serial Number Goods Rule (s. 30(6) and (7)):** provides a special priority rule to govern a situation where a secured party takes a security interest in serial number goods held by the debtor as equipment, where the collateral description in the SA uses a general collateral description (rather than a serial number description) and the buyer does not know of the security interest.

- In the case of equipment, it may sometimes be difficult to maintain a current list of serial numbers for all equipment held, therefore, the SP is given the option of using a general collateral description, with the downside being the accepted risk of loss if the goods are sold to a buyer

**Temporary Perfection Protection (s. 30(5)):** where the security interest is under a temporary perfection rule, the buyer takes free of the security interest where the buyer gave value and was without knowledge of the security interest.

- SP is given a security interest in a piece of heavy equipment owned by D. SP registers a financing statement recording D as the debtor. On March 10, D effects a legal change of name. On March 20, SP learns of the change of name. On March 25, D sells the equipment to B. On March 30, SP registers a financing change statement which adds D's new legal name.
  - B takes free of SP's security interest by virtue of s. 30(5). Although the 15-day grace period which runs from the time SP obtains knowledge is effective against a trustee in bankruptcy or another secured party, it is not effective against a buyer.

## DEFINITION OF SALE:

**s. 30(1):** extends concept of sale to include transactions in which the party acquires an interest in the asset by virtue of the law of fixtures, rather than under a contract of sale, therefore, ensures the priority rules in s. 30 will apply even though the transaction does not fall within the normal definition of sale.

**s. 30(8):** covers sales by cash, credit, or exchange of other property; however, does not cover a transfer that is in total or partial satisfaction of past liability.

- SP is given a security interest in all of D's present and after-acquired personal property. DE, who owes \$10,000 to A, agrees to transfer title to a piece of machinery to A in satisfaction of this debt.

- This transaction does not fall within the definition of sale b/c s. 30(8) requires that the buyer must give new value in order to qualify under the buyer protection rules.

## COMMON LAW PRINCIPLES PER S. 66(3):

**Shelter Principle:** If a buyer acquires an interest in property free of a security interest, that person will be able to pass a good title to subsequent transferees whether or not the transferees gave value or knew of the existence of the security interest. **(per s. 66(3))**

- **SP takes a security interest in D's boats, which are held by D as equipment. SP registers a financing statement which describes the collateral as "boats" in the general collateral field. D sells one of the boats to B1, who did not know of SP's security interest. SP subsequently registers a financing change statement which adds the serial number of all the boats. B1 later sells the boat to B2, who searched the registry and was aware of SP's registration.**
  - SP's security interest was lost upon the sale of the boat to B1 by virtue of s. 30(6) of the PPSA. B1 obtains a good and unencumbered title to boat, and is able to transfer that title to the transferee.

**Actions for Conversion:** supplementary common law remedy that allows a secured party to bring a personal action against the buyer in the tort of conversion. The secured party must have an immediate right to possession (ie. there must have been a default); and, there must have been an intentional exercise of control over the property which is so serious that the transferee must justly be required to pay its full value.

- **SP takes and perfects a security interest in D's mobile home. D later sells the mobile home to B1. The unauthorized sale constitutes an event of default under the terms of the SA. B1 later sells the mobile home to B2.**
  - SP has a personal action against B1, assuming that B1 is unable to invoke any of the buyer priority rules, since the sale by B1 clearly constituted a significant interference with SP's right to possession. The action for conversion is inconsistent with the assertion of a propriety claim to the asset in the hands of B2. SP may therefore elect either to sue B1 in conversion (and possibly B2 as well) or demand possession of the mobile home from B2.

## CASE LAW:

### ***Landson v Saskatchewan Valley Credit Union Ltd (1998 SKCA)*** [application of s. 28(1)(a)]

**Facts:** L loaned N \$16,000 to purchase a mobile home. L registered financing statement. L knew that N would rent the mobile home to sell, their only concern was that N would repay the loan in full upon final sale. N sold the mobile home but did not disclose to L. The buyer did not require financing and did not search the PPR. B sold the mobile home to B2, who obtained financing from SVCU. SVCU registered financing statement. L discovered that mobile home had been sold and attempted to seize it.

**Issue:** Did L authorize N to sell the mobile home as contemplated by s. 28(1)?

**Held:** B takes free of L's security interest so subsequent sale to B2 was unencumbered and B2 was able to grant security interest to SVCU.

**Ratio:** security interest in collateral ceases when the SP authorizes, expressly or by implication, the sale and buyer takes free of the security interest. The authorization must be given *before* the sale. The fact that the debtor subsequently doesn't pay the proceeds, doesn't change the fact that the SP authorized the sale.

### ***Camco Inc v Frances Olson Realty Ltd (1986 SKCA)*** [application of Ordinary Course Buyer Rule s. 30(2)]

**Facts:** C sells appliances to M. M grants security interest to C. M sells the appliances to the condo buyers. M's business model was to supply the appliances with the sale to the individual buyers (which apparently wasn't the regular business practice of the time). The SA between C and M stated that M was not permitted to resell and that the appliance would remain in M's possession until the purchase price was sold.

**Issue:** Where the transaction was not authorized, per s. 28(1)(a), does the buyer priority rule apply such that the buyer will receive priority over the SP?

**Ratio:** Test to satisfy Ordinary Course Buyer Rule:

- 1) **Must be a buyer or lessee of goods;**
- 2) **In the ordinary course of business of the seller; and**  
"ordinary course" case specific to particular seller, not general sellers in the industry

**Factors:**

**Location:** was it transacted in the usual location where these transactions would take place?

**Time:** did it occur during ordinary business hours, on the business premises? (vs. smoky bar at 2am)

**Nature of Buyer/Nature of Customer:** is it seller's usual customer?

**Price:** ex. if selling at deep discount and that's not usual business

**Advertising:** does advertising reflect the practice

**3) The SI must have been granted by the seller; and**

If goods are subject to a perfected SI in the goods given by someone other than the seller, the buyer cannot rely on s. 30(2) to assert priority over the holder of such interest

**4) Was the buyer unaware that the sale would breach the SA?**

**Royal Bank of Canada v Wheaton Pontiac Buick Cadillac GMC Ltd (1990 SKQB):**  
[limitation of s. 30(2)]

**Facts:** RBC enters SA with Key West Motor Products (K), in all of K's inventory. RBC registers but does not register serial numbers of each vehicle. K goes into receivership. K sells four vehicles to KS, not in the ordinary course of business. KS then sells the vehicles to D, D sells to W. W sells, in the ordinary course of its business, to M. RBC learns of these sales and makes the demand against M for the vehicle.

**Issue:** Who has priority in respect of the vehicle between RBC and M?

**Held:** RBC has priority over M such that it can assert its security interest against M because, in the original sale from K to KS, KS did not take the vehicle free of RBC's interest because the sale was not in the ordinary course of business. Therefore, KS did not have unencumbered title to pass along.

**Ratio: Buyers only take free from security interests granted by the seller that sells to them. Where there is a sale that does not fall into one of the ordinary course buyer rules, followed by a transfer that does fall into one of the ordinary course buyer rules, s. 30(2) does NOT apply. The seller of the second transfer was not the party that granted the security interest.**

**Remedies in this Case:**

Had M not be locatable, RBC would not have the ability to assert proprietary right in the case, however, RBC could sue KS, D, and W for tort of conversion b/c they interfered with RBC's immediate right of possession.

Had RBC seized the vehicle from M, M could sue W for the implied condition of right to sell under the *Sale of Goods Act*. W could then sue D for breach of contract and D could then sue S for breach of contract.

**Royal Bank of Canada v 216200 Alberta Ltd (1986 SKCA)**  
["sale" under Ordinary Course Buyer Rule]

**Facts:** Corp. sells home goods (waterbeds). Corp. grants GSA in all goods to RBC. Corp then sells goods to customers. In some cases, there was full payment by customers but store didn't have anything in stock matching that description. Other customers only made deposits. Corp didn't have the goods in stock at the time they went into receivership.

**Issue:** Does a security interest that covers all present and after acquired inventory of retail vendor take priority over claims of persons who in the ordinary course of business have placed a deposit or made a partial payment on goods in the possession of the vendor; or prepaid all or a portion of the purchase price of goods not in the possession of the vendor?

**Ratio: A buyer can take property free of a SI held by a SP if the buyer can establish:**

- 1) **There has been a sale; and** (agreement to sell not enough)
- 2) **They are a buyer in the ordinary course of the seller's business.**

**Commentary:** Look to the *Sale of Goods Act* to determine "sale":

s. 3(4): when under a contract of sale the property in the goods is transferred from the seller to the buyer, the contract is called a sale, but when the transfer of the property in the goods is to take place at a future time or subject to some condition subsequently to be fulfilled, the contract is called an agreement to sell.

s. 18: when there is a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer until the goods as ascertained.

s. 19 (1): when there is a contract for the sale of specific or ascertained goods, the property in them is transferred to the buyer at the time that the parties to the contract intend it to be transferred.

s. 19(2): for the purpose of ascertaining the intention of the parties, regard shall be had to the terms of the contract, the conduct of the parties and the circumstances of the case.

**Spittlehouse v Northshore Marine Inc (1994 ONCA):**  
["sale" under Ordinary Course Buyer Rule—Opposition of RBC v 216200]

**Facts:** S entered into contract with N for a boat. S has paid of 90% of the purchase price and are willing to pay the balance upon delivery of the boat. Transamerica Commercial Finance Corporation has a perfected security interest in all assets of N (including the boat and the contract of sale which provides title shall be transferred when payment is made in full). N defaulted on its loan from T. T seized the boat.

**Issue:** Who has priority as between S and T? (qualification of property passing into S)

**Held:** S has priority over T per s. 30(2) and gets the boat, even though N still holds title.

**Ratio: An agreement to sell is sufficient to be considered a sale under s. 30.**

## EXAMPLES:

- 1) D gives SP a security interest in all of D's present and after acquired refrigerators. SP perfects by registering a financing statement that properly records D's name and describes the collateral as "refrigerators" in the general collateral field. The SA expressly provides that D shall not sell the collateral without the written consent of SP. Without authorization, D in the ordinary course of business sells a refrigerator to B. B did not know of SP's security interest. Does the buyer take the refrigerator free and clear, or subject to SP's security interest?
  - a. B takes free of SP's security interest per s. 30(2)—sale in the ordinary course of business does not necessitate that buyer does not know about the security interest, only requires that buyer not know the security interest was in breach of the SA.
- 2) After acquiring the refrigerator (B taking free of security interest of SP), B subsequently sells it to C. C at the time of this sale was aware that D had given a security interest in all of its refrigerators to SP and that SP did not authorize the sale to B. Does C take free of SP's security interest?
  - a. C takes free of SP's security interest b/c of Shelter Principle: if I acquire good title free and clear of a security interest, that means that security interest is cut off and I have full unencumbered title so B was able to pass good title to C or anyone else, regardless of their state of knowledge
- 3) D gives SP a security interest in all of D's present and after acquired personal property. SP perfects by registering a financing statement that properly records D's name and describes as "all present and after-acquired personal property" in the general collateral field. The truck is being held as equipment and D is not in the business of selling trucks. SP also records the serial number of a Ford Truck in the serial number field. Later D acquires a Dodge truck. D without authorization sells both the Ford Truck and the Dodge truck outside of the ordinary course of its business to B. B did not know of SP's security interest. What interests, if any, does B take free of SP's security interest?
  - a. B takes only the Dodge truck free of SP's security interest.
    - i. Starting point for analysis is s. 28(1)(a), but when collateral is sold the SP did not expressly or impliedly authorize the sale free and clear→the security interest was perfected for both trucks b/c the collateral description in the Financing Statement was satisfactory to bring both under the clause (b/c you don't *need* to register serial number for equipment), so s. 20 doesn't come into play→ s. 30(2) doesn't apply b/c not a sale in the ordinary course of business→s. 30(3) doesn't apply b/c assuming the truck was sold for more than \$1000→s. 30(7) SP needed to register the Dodge as a serial number good once the truck was acquired but they didn't know so b/c of the lack of serial number, s. 30(6) comes into play and the buyer takes free of the security interest

## CHAPTER EIGHT: COMPETITION WITH SECURED PARTIES

### LEGISLATION:

#### Residual Priority Rules:

##### s. 35:

- (1) Where this Act provides no other method for determining priority between security interests,
- (a) priority between perfected security interests in the same collateral is determined by the order of occurrence of the following:
    - (i) the registration of a financing statement, without regard to the date of attachment of the security interest,
    - (ii) possession of the collateral under s. 24, without regard to the date of attachment of the security interest, or
    - (iii) perfection under s. 5, 7, 26, 29, or 77whichever is earlier
  - (b) a perfected security interest has priority over an unperfected security interest, and
  - (c) priority between unperfected security interests is determined by the order of attachment of the security interests.
- (2) For the purposes of subsection (1), a continuously perfected security interest shall be treated at all times as having been perfected by the method by which it was originally perfected.
- (3) Subject to section 28, for the purposes of subsection (1), the time of registration, possession or perfection of a security interest in original collateral is also the time of registration, possession or perfection of its proceeds.
- (4) a security interest in goods that are equipment and are of a kind prescribed by regulations as serial number goods is not registered or perfected by registration for the purposes of subsection (1), (7) or (9) unless a financing statement relating to the security interest and containing a description of the goods by serial number is registered.
- (5) subject to subsection (6), the priority that a security interest has under subsection (1) applies to all advances, including future advances.
- (6) a perfected security interest that would otherwise have a priority over a writ of enforcement issued under the *Civil Enforcement Act* has priority only to the extent of
- (a) advances made before the secured party acquires knowledge of the writ within the meaning of s. 32 of the *Civil Enforcement Act*,
  - (b) advances made pursuant to an obligation owing to a person other than the debtor entered into by the secured party before acquiring the knowledge referred to in clause (a), and
  - (c) reasonable costs incurred and expenditures made by the secured party for the protection, preservation or repair of the collateral.
- (7) subsection 8 applies to re-registration of a security interest the registration of which has lapsed as a result of a failure to renew the registration or has been discharged in error or without authorization
- (8) if the secured party re-registers a security interest within 30 days after the lapse or discharge of its registration, the lapse or discharge does not affect the priority status of the security interest in relation to a competing perfected security interest or registered writ of enforcement that, immediately prior to the lapse or discharge, had a subordinate priority position, except to the extent that the competing security interest secures advances made or contracted for after the lapse or discharge and prior to the re-registration.
- (9) where a debtor transfers an interest in collateral that, at the time of the transfer, is subject to a perfected security interest, that security interest has priority over any other security interest granted by the transferee before the transfer, except to the extent that the security interest granted by the transferee secures advances made or contracted for
- (a) after the expiry of 15 days from the day of the secured party who holds the security interest in the transferred collateral has knowledge of the information required to register a financing statement disclosing the transferee as the new debtor, and
  - (b) before the secured party referred to in clause (a) amends the registration to disclose the name of the transferee as the new debtor or takes possession of the collateral
- (10) subsection 9 does not apply where the transferee acquires the debtor's interest free from the security interest granted by the debtor.

#### Proper Exercise of Rights, Duties, and Obligations:

##### s. 66:

- (1) all rights, duties or obligations arising under a security agreement, under this Act or under any other applicable law shall be exercised or discharged in good faith and in a commercially reasonable manner.
- (2) a person does not act in bad faith merely because the person acts with knowledge of the interest of some other person.
- (3) the principles of the common law, equity and the law merchant, except insofar as they are inconsistent with the express provisions of this Act, supplement this Act and continue to apply.

## GENERAL PRIORITY RULE:

**General Priority Rule (s. 35):** where you have a dispute between secured parties who have competing security interests in the same collateral, s. 35 provides, unless one of the special priority rules applies, that the party to take the perfection step first has priority.

- **Perfect vs Perfected (s. 35(1)(a)):** priority to first SP to have completed perfection step.
- **Perfect vs Unperfected (s. 35(1)(b)):** priority to SP who is perfected.
- **Unperfected vs Unperfected (s. 35(1)(c)):** priority to SP to attach first, however, once SP determines there is an issue, should just take perfection step and perfect to beat out the other party.
- **On July 10, SP1 registers a financing statement recording D as the debtor and properly describing the collateral. Although D had submitted a loan application on July 1, a security agreement was not signed by D until August 15. D obtained a loan from SP2 and gave SP2 a security interest on July 25. On July 30, SP2 properly registered a financing statements. Who has priority as between SP1 and SP2?**
  - SP2 was the first to obtain an attached security interest (July 25) and was also the first to have a perfected security interest (July 30). However, SP1 is given priority per s. 35(1) since SP1 was the first to complete a perfection step (July 10).

**Continuity of Perfection (s. 23; 35(2)):** where a secured party changes the method of perfection (from possession, registration or temporary perfection to possession, registration or temporary perfection), s. 23 provides that a change in the method will not alter the priority status of the security interest so long as the interest is continuously perfected.

- **On January 15, SP1 perfects a security interest in goods by taking possession of them. D gives SP2 a security interest in all of D's goods and SP2 registers on April 15. On October 1, SP1 releases possession of the goods to the debtor. On October 25, SP1 registers a financing statement describing the goods. Who has priority as between SP1 and SP2?**
  - SP2 has priority over SP1. There is a gap in continuity of perfection of SP1's security interest (perfection from Jan 15-Oct 1; Oct 25-, but not between Oct 1-Oct 25). In applying s. 35(1) it is the date of registration (October 25<sup>th</sup>), rather than the original date of possession (January 15) that is now used for determining perfection step dates for the purposes of determining priority.
  - Had SP1 registered before releasing possession of goods to D, SP1 would enjoy priority over SP2 since s. 23 and 25(2) provide that the date of the original perfection step would be used.

**Serial Number Goods (s. 35(3), (4)):** where the security interest deals with serial number goods, the interest will not be perfected by registration unless the financing statement contains a serial number description, per s. 35(4).

- **SP1 takes a security interest in all of D's present and after-acquired personal property. On March 1, SP1 registers a financing statement which describes the collateral as "all present and after-acquired personal property". SP2 takes a security interest in a delivery truck held by D as equipment. On March 5, SP2 registers a financing statement that describes the collateral by serial number. On March 10, the debtor makes an assignment in bankruptcy. Who has priority as between SP1 and SP2?**
  - SP2 has priority over SP1. SP1's registration is not sufficient to qualify as a perfection step for the purposes of s. 35 b/c it lacked the serial number in the registration documents.
- **Who has priority as between SP1 and the trustee in bankruptcy?**
  - SP1's security interest is perfected for other purposes; b/c the Regulations permit a general collateral description to be used when equipment is the collateral. Therefore, SP1's security interest is perfected, per s. 20(a) and will have priority over D's trustee in bankruptcy.

**Future Advances and Priorities (s. 35(5); s. 14):** the priority a security interest has under s. 35(1) extends to future advances, per s. 35(5). Previous rule in *Hopkinson v Rolt* permitted a secured party to "tack" future advances only where the secured party did not know of the existence of an intervening party.

- Note: SA must explicitly extend to future advances (per s. 14)
- **SP1 is given a security interest in all of D's present and after-acquired personal property to secure all present and future indebtedness. On September 5, SP1 registers a financing statement. On September 6, SP1 advances \$10,000 to D. On September 20, SP2 is given a security interest in D's inventory, which SP2 registers on September 21. On September 25, SP1 learns of SP2's security interest. On September 30, SP1 makes a further advance of \$25,000 to D. Who has priority?**
  - SP1 has priority over SP2 for both the initial loan of \$10,000 as well as the further advance of \$25,000.
- **Exception:** if the secured party knows of the existence of a writ of enforcement, the secured party cannot tack future advances in priority to the writ per s. 35(6); b/c a secured party who knows of a writ is no longer assured of priority, s. 14(2) provides that the secured party is released from any contractual obligation to make the advance to the debtor.
  - **Actual Knowledge** of SP required; constructive knowledge not enough (ie. not enough just to register), therefore, writ holder should contact SP1 and let them know of registration.

## EXCEPTIONS TO THE GENERAL PRIORITY RULE:

**Re-Registration on Lapse or Discharge (s. 35(7), (8)):** when a registration lapses or is discharged it is removed from the registry system. A lapse or discharge can result in the loss of priority, except where the lapse/discharge occurs as a result of fraud or error and the secured party re-registers within 30 days, whereby the secured party will maintain priority, but only over subordinate secured party's that existed immediately before the lapse, not those secured party's who registered between the lapse and re-registration, per s. 35(7) and (8).

- **Lapse:** when natural life of registration ends
- **Discharge:** where you take deliberate step to terminate before the registration life comes to a natural end, through financing change statement (ie. if loan has been repaid)
- Note: Regulation 18 requires that the re-registering party use the existing registration (registration number) to file reregistration, NOT an entirely new statement.
- **SP1 takes a security interest in the property of D and registers for a 5- year period on April 8, 1994. On May 10, 1995, D gives SP2 a security interest in the same collateral, which SP2 registers that day. On March 15, 1998, SP1 refinances the loan so that it is now expected to be repaid by 2001. SP1 registers a new financing statement and chooses a 3-year registration life. Who has priority?**
  - SP2 has priority over SP1. SP1 made a serious mistake registering a new financing statement instead of renewing its existing financing statement. On April 8, 1999 SP1's first registration lapses. The registration disappears from the computerized registry system. At this point, SP2 beats out SP1's interest.
- **SP1 registers w/ five-year registration. Then SP2 registers. 5-year period runs out. SP3 registers. SP1 re-registers within 30-day period. Who has priority?**
  - **Circular Priority Problem:** SP3 beats out SP1; SP1 beats out SP2; SP2 beats out SP3. So no easy resolution between these parties.
    - 30-day period is short on purpose—want to avoid opportunity for Circular Priority Problem to arise
- **Priority Against Buyer or Trustee in Bankruptcy in the 30-Day Gap:**
  - **If Bankruptcy:** the priority is between SP and Trustee in Bankruptcy; as per s. 20, SI was unperfected at the time of the bankruptcy so the trustee has priority
  - **If Buyer:** if it is a buyer without knowledge, then s. 20 applies and the SP is subordinate to him/her

**Double Debtor Problem (s. 35(9)):** s. 35(1) is premised on the assumption that the same debtor has given security interests in the same collateral to two or more secured parties. However, it is possible that the security interests were given by different debtors. Where this is the case, s. 35(9) applies:

- **D1 gives SP1 a security interest in all present and after-acquired goods which is registered on April 1. D2 gives SP2 a security interest in all present and after-acquired goods which is registered on February 1. D1 then sells office furnishings to D2. None of the buyer priority rules apply so as to cut off SP1's security interest.**
  - SP1 has priority, despite SP2's earlier registration. This priority cannot be claimed by SP1 in respect of any future advances that are made 15 days after SP1 learns of the transfer but before SP1 amends the registration to disclose the new debtor name.
    - Where you have knowledge that collateral has been transferred, you are expected to file a financing change statement, within 15 days.
      - If SP1 fails to file the FCS after the time period expires, then SP1 will be subordinate to SP2 to the extent that SP2 makes any further advances to D2 during that period
- **SP1 takes a security interest in D1's automobile but fails to register it. D1 sells the automobile to D2. However, D2 does not take free of SP1's security interest b/c D2 knew of SP1's unperfected security interest. D2 later gives a security interest in the automobile to SP2.**
  - Law is unsettled here; underlying assumption that s. 35(1) covers the double debtor problem and SP2 has priority over SP2.
- **D1 grants a security interest to SP1, registered on Feb 5<sup>th</sup>. D2 grants a security interest to SP2, registered on Jan 10. D1 sells asset to D2. D1 and D2 default.**
  - **If sale done in the "ordinary course of business" who has priority?**
    - SP2 would have priority b/c D2 took free of SP1's security interest (s. 35(9))and SP2 can apply shelter clause per s. 35(10)
  - **If sale not done in the "ordinary course of business" who has priority?**
    - SP1 beats out SP2 even though SP2 might have registered first for the for the most part
- **Summary:** we give SP1 priority unless:
  - D2 has taken free, or

- If SP1 has knowledge, at this point there is a 15-day window after knowledge to file a registering financing change statement which puts D2s name in. If SP2 makes a future advance in the window after 15-day period has elapsed but FCS has not been filed to the date it has been filed, SP2 will have priority over the future advance.

**Registration and Multiple Security Agreements (s. 43(5)):** secured parties can take advantage of previous registrations, and registrations can cover more than one security agreement. So long as the collateral description provided for in the initial security agreement is sufficient to cover the other SA's, then there is no reason to demand that the SP conduct multiple registrations. (*Agricultural Credit Corp of Sask v RBC*)

**Knowledge, Bad Faith and Priority (s. 66(1), (2)):** knowledge of a prior unperfected security interest does not preclude a secured party from obtaining priority under s. 35(1), unlike those rules in s. 20(b). However, where the secured party not only knew of the existence of a prior unperfected security interest, and acted in bad faith, such as a SP misleading another SP into thinking its security interest was properly perfected (ie. misrepresenting the name of the debtor) or by performing some act which had the effect of delaying the perfection of the other party's security interest. **Per s. 66(1):** the failure to act in good faith, will preclude the secured party from relying upon the priority that would otherwise be available to it.

**Transfer of Debtor's Interest in Collateral OR Change of Debtor's Names (s. 51):** where there is a change in the Debtor's legal name after registration or there is a transfer of debtor's interests, the security interest does not become unperfected, the secured party just loses priority against subsequently created interests unless it acts.

- Clock starts running once SP has **actual knowledge** (per *Royal Bank of Canada v Head West Energy Inc*), then 15-days to file financing change statement.
  - If registration of new SP within that 15-day period, new SP will have priority over SP1.
- Subordination of security interest of SP1 only to those parties listed in **s. 51(3)**:
  - **(a)** A buyer w/out knowledge or a trustee in bankruptcy who acquires the interest after the 15-day lapse but before SP1 registers FCS
    - **s. 30(5):** buyer without knowledge during the 15-day period will get priority
  - **(b)** a perfected SI in the collateral registered or perfected after expiry of the 15-day grace period and before the SP registers FCS
  - **(c)** a perfected SI in the collateral will have priority over SP1 if they acquire the interest both within the 15 day grace period and after the 15 day grace period if the initial SP does not register within the 15 day period.

#### Supplementary Principles:

- Where the Act does not provide the rules you may need to go to the background principles of common law and equity:
  - ie. where there is simultaneous perfection and attachment
  - ie. SP vs beneficiary under a trust
  - ie. SP takes an SI in collateral and then debtor sells to 3<sup>rd</sup> party—s. 28(1)(a) has codified the *nemo dat* principle
  - ie. where SP has given away SI, the SP may be estopped from claiming SI or enforcing it
    - estoppel by representation: I make a rep to you that I do not have an SI, you buy it, I am then estopped from claiming my SI
    - promissory estoppel: I promise not to enforce my interest against you, or I promise I will release it and then I do not, I am estopped from enforcing then

**Subrogation:** allows the substitution of the rights of one party for the rights of another with reference to a lawful claim, demand or right, so that he who is substituted succeeds to the rights of the other in relation to the debt or claim, and its rights, remedies, or securities.

- A person whose money is used to pay off a secured debt acquires the secured creditor's security interest, the courts of equity treat that person whose money is used to pay off the debt as having had the security interest assigned to them
  - If you pay out a loan, you become subrogated to the rights of the Creditor who you paid out

**Marshalling of Securities (s. 66(3)):** where SP1 has a SA in Goods and Accounts, and a subordinate SP has SA only against Accounts, both SP will only get repayment of their obligation, nothing more. However, where SP1, who has priority, is entitled to enforce its security in any way that it chooses (can go after the Goods and/or Accounts to settle D's repayment obligation). Where SP1 goes after Accounts, and depletes the available Accounts, SP2 will be subrogated to SP1's rights to the Goods.

- **SP1 has SA in Goods and Accounts to secure \$100,000. SP2 who is subordinate in priority has a security interest only against Accounts, which secures an obligation of \$50,000. The Goods are worth \$150,000 and the Accounts are worth \$50,000.**
  - SP1 can go after \$100,000 of the total \$200,000 and can take from Goods and/or Accounts, as they choose

- SP2 can only go after \$50,000 of the total \$50,000 in Accounts, and only what amount remains after SP1 has gotten back their repayment obligation.
  - Whatever amount of SP2's obligation that is not attainable from Accounts, as a result of SP1's depletion will be subrogated to SP2 from Goods.
- **SP1 has SA in Goods and Accounts to secure \$100,000. SP2 who is subordinate in priority has a security interest only against Accounts, which secures an obligation of \$50,000. SP3 has \$25,000 interest in Accounts.**
  - Depending on SP1's choice, and if subrogation theory is used, either SP2 or SP3 could be wiped out, therefore, in such a case, SP2 and SP3 will share the loss, pro-rate, resulting from SP1's choice.
- Note: application of **Steinbeck**: Courts will force SP1 to go after the goods to leave the accounts available to SP2
  - However, Manitoba case

## CASE LAW:

### ***Shallcross v Community State Banks Trust Co (1981 NJSC):***

**Ratio: Knowledge of the existence of an unperfected security interest is not enough to prevent you from invoking s. 35.**

### ***Agricultural Credit Corp of Saskatchewan v Royal Bank of Canada (1994 SKCA):***

**Facts:** ACS makes a security agreement for Loan A, with no future advances clause (only covers Loan A) and registers. RBC then registers GSA, covering all present and after acquired personal property and registers. ACS refinances Loan A, via Loan B, with the GSA covering future advances, registers. Then ACS makes a further loan, Loan C.

**Issue:** Who, between ACS and RBC, has priority?

**Held:** ACS has priority over everything because they registered and it covered all property.

**Ratio: A registration can cover more than one security agreement. New financing statements do not need to be registered if the information in the first registration is sufficient.**

### ***Royal Bank of Canada v Head West Energy Inc (2007 ABQB):***

**Facts:** Head West granted a security interest to Wells Fargo in four industrial trailers. Wells Fargo registered. Head West changed its name. Wells Fargo did not amend its registration. Then, RBC registered financing statement in 50% of three industrial trailers and 100% in one of the trailers and registered. Then Wells Fargo amended registration (almost 15 months after name change). Head West went bankrupt. Wells Fargo claims they did not learn about the change of name until learning of the appointment of the receiver.

**Issue:** Between RBC and Wells Fargo, who has priority?

**Ratio: actual and constructive knowledge of a change to debtor's name is required to satisfy an application under s. 51.**

### ***Re N'Amerix Logistics Inc (2001 ONSC):***

**Facts:** Bank of Nova Scotia has a GSA with EBF. EBF has a factoring agreement (buy accounts receivable) with BNS and registers but has a registration error. EBF pays off loan with BNS. Then bankruptcy occurs.

**Issue:** Was EBF subrogated to BNS's GSA (which was perfected) such that EBF has priority over the trustee in bankruptcy?

**Ratio: Doctrine of Subrogation applies; if you pay out the loan then you become subrogated, entitled in equity to stand, as against the property, in the shoes of the secured party.**

### ***Carson Restaurants International Ltd v A1 United Restaurant Supply Ltd (1989 SKQB):***

**Facts:** A1 enters into security agreement but invalid registration (debtor name has seriously misleading error). Y (debtor) had previously granted security agreement to C. Mr. S was the director of Y and C, so he didn't register the SA. Y went into financial difficult. A1 pressuring them to pay. Mr. S told them not to enforce security agreement against Y, and gave assurances to A1, then searched registry and found that they had an unperfected registration, so went to the registry and registered. A1 then made amendment.

**Held:** The directing mind deceitfully delayed the enforcement of the security interest in order to undermine A1's position; this is more than mere knowledge and is a sufficient act of bad faith.

**Ratio: Delay of registration of a security interest could be classified as bad faith, in contradiction of s. 66, such that priority will be given to the good faith party.**

### ***Steinbach Credit Union Ltd v Manitoba Agricultural Credit Corp (1991 MNQB):***

**Ratio: Doctrine of Marshalling operates to compel the creditor who has recourse to both estates or funds to exhaust the assets against which it alone has a claim before having recourse to the assets in which the other claimant has an interest.**

## EXAMPLES:

- 1) Five years ago, D gave SP1 a security interest in all of D's present and after acquired personal property, which SP1 properly registered. D later gave SP2 a security interest in all of D's present and after-acquired personal property, which SP2 properly registered on January 5 of this year. On March 1, SP3 registered a financing statement on "all present and after acquired personal property". On March 15, SP1 refinanced its loan and obtained a new security agreement and SP1 registered a new financing statement which described the collateral as "all present and after acquired personal property". On April 1, SP3 was given a security interest in all of D's present and after acquired personal property. On April 5, SP1's original registration lapsed. Rank the priority competing security interests.
  - a. SP2→SP3→SP1
    - i. All of the Sis are perfected so using 35(1)(a) which says we give priority to the first person who registers. SP1 has registered first, but the registration was ongoing and it lapsed, therefore, that registration, as of April 5<sup>th</sup>, came off the system. SP1 could have preserved priority against subordinate parties, if within 30 days they re-registered under 35(7)/(8) but there is no indication that they did. SP2 registered before SP3 and both registered before SP1 refinanced on March 15<sup>th</sup>.
- 2) D gave SP1 a security interest in all present and after acquired personal property and SP1 properly registers on August 15. On September 5, SP1's registration is inadvertently discharged. D then gave SP2 a security interest in D's assets which SP2 registered on September 15. On September 25, SP1 re-registered using the special procedure provided for re-registration after lapse or discharge. D then gave SP3 a security interest in all of D's assets which SP3 registered on September 30. Rank the priority of the competing interests:
  - a. SP2→SP1→SP3
    - i. SP1's security interest was discharged on September 5, SP2 then given security interest. If SP1 re-registered in the 30 days they would maintain priority over subordinate parties immediately prior to the discharge. However, SP2 was not an interest until after the discharge and before the registration amendment.
- 3) Desert Fox Clothing Ltd (DFC) gave ATB a security interest in all of its present and after-acquired goods, which ATB registered on February 25. Canabrian Enterprises (CEL) gave CIBC a security interest in a computer, which CIBC registered on March 10. On April 15, CEL sold the computer to DFC. The sale did not have the effect of cutting off CIBC's security interest. On May 5, CIBC learned of the sale. On May 15, ATB made a further advance of \$10,000 to DFC. Rank the priority of the competing interests.
  - a. S. 35 (9) applies; s. 35 (10) exception does not apply. CIBC will have priority, even though ATB had earlier registration b/c we don't apply first registration rule when have two debtors. ATB loses priority unless it fits within the language of (9), however, the advance was not made after the expiry of 15 days from the day the secured party has knowledge.

# CHAPTER NINE: PURCHASE-MONEY SECURITY INTERESTS

## LEGISLATION:

### Priority of Purchase-Money Security Interests:

#### s. 34:

(1) In this section, “non-proceeds security interest” or “non-proceeds purchase-money security interest” means a security interest or purchase-money security interest, as the case may be, in original collateral.

(2) a purchase-money security interest in

(a) collateral, or subject to s. 28, its proceeds, other than intangibles or inventory, that is perfected not later than 15 days after the day the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier, or

(b) an intangible or, subject to s. 28, its proceeds, that is perfected not later than 15 days after the day the security interest in the intangible attaches

has priority over any other security interest in the same collateral given by the same debtor.

(3) subject to subsection (6), a PMSI in inventory or, subject to s. 28, its proceeds, has priority over any other security interest in the same collateral given by the same debtor if

(a) the PMSI in the inventory is perfected at the time the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier,

(b) the secured party gives notice to any other secured party who has, before the registration of the PMSI, registered a financing statement containing a description that includes the same item or kind of collateral,

(c) the notice referred to in clause (b) states that the person giving the notice expects to acquire a PMSI in inventory of the debtor, and describes the inventory by item or kind, and

(d) the notice is given before the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier.

(4) a notice referred to in (3) may be given in accordance w/ s. 72 or by registered mail addressed to the address of the person to be notified as it appears in the financing statement referred to in (3)(b).

(5) a PMSI in goods, or subject to s. 28, its proceeds, taken by a seller, lessor or consignor of the collateral is perfected

(a) in the case of inventory, at the date the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier, and

(b) in the case of collateral other than inventory, not later than 15 days after the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier,

has priority over any other PMSI in the same collateral given by the same debtor.

(6) a non-proceeds security interest in accounts given for new value has priority over a PMSI in the accounts as proceeds of inventory if a financing statement relating to the security interest in the accounts is registered before the PMSI is perfected or a financing statement relating to it is registered.

(7) a non-proceeds PMSI has priority over a PMSI in the same collateral as proceeds if the non-proceeds PMSI,

(a) in the case of inventory, is perfected at the date the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier, and

(b) in the case of collateral other than inventory, is perfected not later than 15 days after the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier.

(8) for the purposes of this section, where goods are shipped by common carrier to a debtor or to a person designated by the debtor, the debtor is deemed not to have obtained possession of the goods until the debtor, or another person at the request of the debtor, has obtained actual possession of the goods or a document of title to the goods, whichever is earlier.

(9) a perfected security interest in crops or their proceeds, given for value to enable the debtor to produce or harvest the crops and given

(a) while the crops are growing, or

(b) during the 6-month period immediately prior to the time when the crops became growing crops,

has priority over any other security interest in the same collateral given by the same debtor.

(10) a perfected security interest in fowl, cattle, horses, sheep, swine, fish or their proceeds given for value to enable the debtor to acquire food, drugs or hormones to be fed to or placed in the fowl, animals or fish has priority over any other security interest in the same collateral given by the same debtor other than a perfected PMSI.

### Priority of PMSI

#### s. 22:

(1) a PMSI in

(a) collateral, other than an intangible, that is perfected not later than 15 days after the day that

(i) the debtor obtains possession of the collateral, or

(ii) a third party, at the request of the debtor, obtains possession of the collateral,

whichever is the earlier, or

(b) an intangible that is perfected not later than 15 days after the day the security interest attaches

has priority over the interests of persons referred to in s. 20(a).

(2) for the purposes of this section, where goods are shipped by common carrier to a debtor or to a person designated by the debtor, the debtor does not have possession of the goods until the debtor or the third person, at the request of the debtor, has obtained actual possession of the goods or a document of title to the goods, whichever is earlier.

## PURCHASE-MONEY SECURITY INTERESTS:

**Purchase- Money Security Interests:** priority rule in favor of a PMSI over another competing security interest even though it was first in time. **Covers:**

- 1) Vendor- Based Financing (Secured Credit Sales): Secured credit sales under which a seller sells goods to a buyer and reserves a security interest in the goods that are sold in order to secure the unpaid purchase price and credit charges;
  - a. Seller sells goods to a buyer on credit and takes a SI in the goods in order to secure the unpaid purchase price and credit charges
- 2) Lender Based Financing (Purchase Money Loan): Purchase-money loans under which a lender advances funds to a debtor for the purpose of allowing the debtor to acquire a new asset, and the funds are used for this purpose; where:
  - a. 1) *purpose requirement:* credit must have been given to permit the debtor to acquire the new asset; and
  - b. 2) *tracing requirement:* the funds must in fact have been used for the purpose
    - i. often the SP will make the advance directly to the seller rather than the buyer in order to ensure this requirement is satisfied
- 3) A lease for a term of more than one year; (deemed SI under s. 3(2))
  - a. If you fall within this definition, then you have a *deemed* PMSI
    - i. Have to register in order to beat out existing secured interests
- 4) A commercial consignment; (deemed SI under s. 3(2))
  - a. if you fall within this definition, then you have a *deemed* PMSI
    - i. have to register in order to beat out existing secured interests

**Note:** Substance over Form—whether a transaction creates a PMSI depends on substance, not form so irrelevant whether parties refer to a PMSI, fail to call the transaction a PMSI, or incorrectly refer to something has a PMSI. (*Wheatland v Baschuk*)

- in particular, look to whether a new asset was added/acquired (*Wheatland*)
- Does not need to be *explicitly* referred to (*Clark Equipment*)

**Note:** you can create a PMSI and an SI in the same agreement; where an agreement does this, it will give rise to a PMSI in the new collateral that is being financed and a non- PMSI in the additional collateral, but only qualifies as a PMSI to the extent that the agreement secures the purchase money obligation, otherwise it is a normal SI (*Clark Equipment*)

- **SP makes a loan to D to acquire a new fork lift. The security agreement says SP takes SI in all present and after-acquired personal property.**
  - PMSI will apply to fork life; Non- PMSI in APAAPP
- **Lender loans to D to buy a new truck. The security agreement states that SP takes SI in truck and all-obligations clause.**
  - Further loans from SP to the D are secured by SI in the truck, but these do not have PMSI status.

**Rationale:** the super-priority rule (2<sup>nd</sup> in time, yet 1<sup>st</sup> in right) of a PMSI is intended to reduce the situation where a D who has given an SI in “all present and after acquired personal property” finds it difficult to obtain secured financing from another source, since it’s the 2<sup>nd</sup> source and would be subordinate to the earlier secured party’s SI.

## PROCEDURAL REQUIREMENTS:

**PMSI Basic Rule (s. 34(2)(a)):** PMSI must be perfected no later than 15 days after the debtor obtains possession of the collateral

- 15-day period runs from the time the debtor obtains possession of the collateral (as opposed to the time the PMSI was entered into) (*Mack Canada Inc v Essential Concrete Ltd*)

**PMSI in Intangibles (s. 34(2)(b)):** PMSI must be perfected no later than 15 days after the security interest attaches.

- 15-day period runs from the time the security interest attaches

**PMSI in Inventory (s 34(3)):** in the case of inventory, PMSI must:

- 1) Be perfected before the debtor obtains possession of the inventory; and
- 2) Notice must be given to a secured party who has an earlier registration;
  - a. Must indicate intention to take PMSI in inventory;
  - b. Describe the inventory by type or kind; and
  - c. Be given before the debtor obtains possession of the inventory

## PMSI SCENARIOS:

**Two-Debtor Problem:** Super priority in s. 34(2) and (3) only applies where the competition is with a security interest in the same collateral, given by the same debtor.

- **SP1 is given a security interest in D's commercial bakery oven which SP1 perfects by registration. D sells the oven to B without authorization and outside of D's ordinary course of business. SP2 made a purchase-money loan to B to enable B to acquire the oven from D. SP2 registers within the requisite 5-day period.**
  - Where this occurs:
    - S. 34 does not apply to give priority to SP2, even though SP2 has a PMSI in the oven, because the competing security interests must be given by the same debtor in the same collateral in order for s. 34(2) and (3) to apply.
    - Here: SP1's security interest was given by D, while SP2's security interest was given by B. Therefore, SP1 has priority over SP2 by virtue of the ordinary rules found in s. 35.

**PMSI Lender vs PMSI Lender in the Same Collateral:** where competition arises between two PMSI in the same collateral, where both SPs extend a loan to the Debtor to purchase a single item, apply **s. 35**.

- **SP1 and SP2 both make a purchase-money loan of \$10,000 to enable D to purchase a vehicle for \$20,000. D uses the funds to buy the vehicle and obtains possession of it on December 5. SP1 registers on December 10. SP2 registers on December 15.**
  - a. Where both of the secured parties have PMSI in the same collateral, the residual first in time rule of **s. 35** is used to resolve the priority competition
  - b. Therefore, SP1 is given priority on the basis of SP1's earlier registration

**PMSI Seller vs PMSI Lender in the Same Collateral:** seller prevails in regards to Goods per **s. 34(5)**, apply **s. 35** where not goods

- **Purchase-money lender provides funds that are used by D in making a down-payment towards the purchase-price, with the balance financed by the seller.**
  - c. Where one of the secured parties is a seller who takes a PMSI in goods that are sold to the debtor and the other secured party is a purchase-money lender:
    - i. Seller has priority over lender per **s. 34(5)**, provided that procedural steps in (2) and (3) have been completed

**Non-Perfection and PMSIs:** **s. 22** provides a limited exception to the rule that an unperfected security interest at the date of the debtor's bankruptcy is subordinate to the trustee (per s. 20(a), in the case of a PMSI, where the security interest is perfected not later than 15 days after the debtor obtains possession of the goods (or 15 days after attachment in the case of an intangible).

- **Note:** priority only applies to persons mentioned in **s. 20(1)(b)**, therefore, s. 22 does NOT apply where a transferee acquires an interest in the collateral before the PMSI is perfected, even if the PMSI is later registered within the 15-day period.

**Security Interests in Crops and Animals (s. 34(9) and (10):** (9) where a secured party gives value to enable a debtor to acquire seed, fertilizer, herbicides, pesticides or other inputs that are used to produce a crop, and takes a security interest in the crop. The secured party who finances the inputs obtains priority over a prior perfected security interest, or (10) where a secured party gives value to enable the debtor to acquire food, drugs or hormones for livestock or other animals and takes a security interest in those animals. The secured party who finances the inputs obtains priority over a prior perfected security interest, except where another secured party has a PMSI in the animals.

**Consolidations and Re-Financings:** to what extent a PMSI will survive a re-financing or consolidation:

- **Loan Consolidation:** occurs when the debtor has a number of different loans outstanding and consolidates them all such that they become one big loan requiring one payment per month
  - Where debts are consolidated, the PMSI status will survive

- Consolidation allows you to retain your status but does not improve it—you cannot obtain more than you would have, had there not been consolidation
- SP takes a \$50,000 PMSI in D's tractor. SP takes a \$100,000 PMSI in the D's combine. SP then consolidates the two SI's and executes new loan documents under which the obligations are combined into a single loan for \$150,000. The new GSA covers all of the debtor's present and after-acquired personal property.
  - SP has an ordinary SI in the entire debtor's PAAPP—governed by the residual priority rules in s. 35
  - The PMSI status survives and SP can assert its super priority over the tractor and the combine.
- The tractor depreciates, however, \$50,000 is the amount left to pay. The combine is worth \$120,000 but they had a bit of a cushion and they only owe \$100,000. The tractor depreciates in value and is sold for \$30,000 and the combine is sold for \$120,000.
  - Lose 20,000 on the tractor, however, do not gain 20,000 on the combine because that extra 20,000 would go to the previously secured party, who registered prior to the PMSI.
  - Consolidation allows you to retain your status but does not improve it—you cannot obtain more than you would have, had there not been a consolidation
- SP finances a PMSI on a tractor for \$50,000. SP finances a PMSI on a combine for \$100,000. The loans are consolidated for \$150,000. D pays \$60,000 towards the consolidated loan before default. How do we allocate the payment?
  - Little guidance from CDN jurisprudence for allocation; per *Re Conn*: the 60,000 would be applied first to the tractor and then the combine. Per Prof. Wood: the court in Canada may possibly assert a pro rata formula
  - Would make sense that SP would want the non-PMSI agreement paid out first so as to ensure maximum priority in the case of default/bankruptcy; or would want the asset that was depreciating the fastest to be paid off first
  - Would make sense that D would first want the non-depreciating PMSI paid out first and failing that, *pro rata* distribution of payments.
- SP finances a PMSI on a tractor for \$50,000. SP finances a PMSI on a combine for \$100,000. The lender then takes a GSA in all present and after acquired personal property in order to secure the \$150,000 obligation. The lender then advances an additional \$150,000. Then D pays \$150,000 towards the consolidated loan before default.
  - As per *Re Conn*: first in, first out rule—but USA rule.
  - It is always open to the parties to agree as to how the loan payments are to be obligated.
    - It is best to have the \$150,000 being applied to the non-PMSI \$150,000 loan and then you would still maintain PMSI status with regards to the tractor and combine
    - However, had *re Conn* been applied, then money would first be applied to the tractor and combine and the PMSI would be exhausted.
  - Note: there is no jurisprudence in Canada yet that stipulates this would happen yet
- **Re- Financing:** occurs when the SP makes a purchase-money loan and later agrees to adjust the terms of the loan (refinance) (ie. for a lower payment over a longer term)
  - **Wood's Approach:**
    - American Authorities:
      - Look at it from a subrogation prospective (equitable doctrine)—better explanation than *Battlefords* because has the same result but doesn't undermine the policy behind the PMSI and stays in check with the asset pool philosophy
      - The different is that this is a derivative approach, they obtain only the rights that are possessed by the subrogated party, their position does not leap ahead of what they are purchasing
  - Better still:
    - Don't rely on the law of subrogation but take an assignment of their SI—this will transfer whatever SI they have on to yourself and provide better protection for yourself

## CASE LAW:

### *Wheatland Industries v Baschuk (1994 SKQB):*

**Facts:** D's combine was in need of repairs but he could not afford the repairs. He entered into agreement where he sold the combine to the repairman, and the repairer sold the combine back on a secured sale. Subsequently, D ran into financial difficulties and made a series of defaults. There were other outstanding creditors.

**Issue:** Does this scheme, whereby D sold and then repurchased his combine to finance the repair bill, constitute a PMSI?

**Held:** Not a PMSI. There was no enhancement to the buyer's asset pool. There was no acquisition of new collateral, combine was only used as collateral for extension of credit.

**Ratio: Look to substance over form of the agreement. Where a new asset is not added/acquired, the transaction will not be a PMSI.**

***Clark Equipment of Canada v Bank of Montreal (1984 MNQB):***

**Facts:** Maneco, grants a security interest to BMO. Maneco subsequently grants a PMSI to Clark. Clark is 2<sup>nd</sup> to register but met PMSI requirements. Clark's registration covers all present and after acquired personal property (all equipment and machinery, regardless of whether or not supplied by SP2).

**Issue:** Does a PMSI agreement have to be limited to Personal-Money collateral?

**Held:** PMSI agreement does not have to be limited to personal-money collateral, Clark gets super priority.

**Ratio: Where a PMSI and a SI interest is created in the same agreement, the status of the PMSI will be upheld. You do not have to explicitly say that you are taking a PMSI in certain assets. Where the conditions are satisfied in s. 34, the PMSI will be upheld.**

***Mack Canada Inc v Essential Concrete Ltd (2002 ONSC):***

**Facts:** Mack delivered vehicles to Essential on June 29, 2001. In September, having still not been paid for the vehicles, Mack determined it was necessary to take a security interest in the collateral in order to protect its rights. On September 14, 2001 Essential executed the vehicle purchase agreement and a conditional sale agreement. Mack notified prior secured parties of Mack's intention to acquire a PMSI. Mack registered its security interest in the vehicles on September 19, 2001.

**Issue:** Who has priority over the vehicles as between Mack and previously secured creditors?

**Held:** Mack has priority per PMSI b/c E did not gain possession in their capacity as a debtor until September 14, from which there was a 15-day period to register from.

**Ratio: only once you have obtained possession in the capacity as a debtor that the 15-day period begins to run.**

***In Re Conn (1982 USA Case):***

**Facts:** a purchase money loan was consolidated with a non-purchase money-loan.

**Issue:** Does the purchase money nature of a lien survive a subsequent refinancing of the same loan by the same creditor? How do we allocate the payments made on the consolidated loan?

**Ratio: If there is a statutory or contractual provision stipulating how to allocate, then apply that. Where no statutory/contractual formula: apply "First in, first out Rule" (Clayton): payments are directed at the first obligation to be created and once that obligation has been extinguished, the payments are applied to the second obligation.**

***Battlefords Credit Union Ltd v Ilnicki (1991 SKCA):***

**Facts:** BCU made various loans to I, many of which were to allow I to acquire new pieces of farming equipment. BCU consolidated the PMSI loans. 3<sup>rd</sup> parties had PMSI in equipment as well, which BCU bought out before consolidating the loans.

**Issue:** Did the PMSI's of the other creditors survive when I entered into the loan consolidations agreement with BCU?

**Held:** PMSI survived, BCU entitled to seize equipment.

**Ratio: the payout of a security interest gives the lender a PMSI.**

**Commentary:** this is the right ratio but the wrong reasoning because if we used SKCA's reasoning literally, then every time a D uses funds to pay out an SA, whether it be a regular SA or a PMSI, then the resulting lender will be a PMSI, which could have the effect of elevating the lender's rights above what the initial security holder had (unprincipled/unjust).

***New Zealand Bloodstock Leasing Ltd v Jenkins (2007 NZHC):***

Reference made to *Battlefords* approach: the approach, which allows that a new purchase money security interest can be created by a refinancing, is inconsistent with the scheme and intent of the legislation to give effect to transactions in accordance with their substance rather than their form. In reality, the refinanced debtor acquires no greater right to the economic value of the collateral by reason of the refinancing; the debtor is merely exchanging one creditor for another, or one financing structure for another. The refinancing creditor has not increased the asset pool of the company.

***Chrysler Credit Canada Ltd v Royal Bank of Canada (1986 SKCA):***

**Facts:** C advanced loans to White, a car dealer, for the purchase of new Chrysler cars and registered an SI over all the cars purchased with the loans. C had a PMSI with respect to the inventory of new vehicles. Some customers had given trade-in automobiles when they purchased new automobiles from White. RBC registered an SI over all of W's inventory and proceeds there from. W went bankrupt and the TIB returned all the new cars to C, but not the used trade-ins.

**Issue:** To what extent does C have priority over the used trade-ins?

**Held:** It is possible to pool all the obligations and the PMSI could secure all those obligations.

**Commentary:** this is incorrect—you can't have a PMSI once a purchase money obligation has been paid out—the PMSI is extinguished at this point.

## LEGISLATION:

### Perfection Regarding Proceeds:

**s. 28(1):** Subject to this Act, where collateral is dealt with or otherwise gives rise to proceeds, the security interest

- (a) continues in the collateral, unless the secured party expressly or impliedly authorized the dealing,
- (b) extends to the proceeds,

but where the secured party enforces a security interest against both the collateral and the proceeds, the amount secured by the security interest in the collateral and the proceeds is limited to the market value of the collateral at the date of the dealing.

**(1.1)** the limitation of the amount secured by a security interest as provided in (1) does not apply where the collateral is investment property.

**(2):** a security interest in proceeds is a continuously perfected security interest if the interest in the original collateral is perfected

- (a) by registration of a financing statement that contains a description of the proceeds that would be sufficient to perfect a security interest in original collateral of the same kind,
- (b) by the registration of a financing statement that covers the original collateral, if the proceeds are of a kind that are within the description of the original collateral, or
- (c) by the registration of a financing statement that covers the original collateral, if the proceeds consist of money, cheques or deposit accounts in a financial institution

**(3):** where the security interest in the original collateral was perfected other than in a manner referred to in (2), the security interest proceeds is a continuously perfected interest but becomes unperfected on the expiration of 15 days after the security interest in the original collateral attaches to the proceeds, unless the security interest in the proceeds is otherwise perfected by any of the methods under the circumstances prescribed in this Act for original collateral of the same kind.

### Residual Priority Rules:

**s. 35(2):** For the purposes of (1), a continuously perfected security interest shall be treated at all times as having been perfected by the method by which it was originally perfected.

### Priority of Purchase Money Security Interests:

**s. 34(2):** a purchase money security interest in

- (a) collateral or, subject to s. 28, its proceeds, other than intangibles or inventory, that is perfected not later than 15 days after the day the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier, or
- (b) an intangible or, subject to s. 28, its proceeds, that is perfected not later than 15 days after the day the security interest in intangible attaches

has priority over any other security interest in the same collateral given by the same debtor.

**s. 34(3):**

**(3)** subject to subsection (6), a PMSI in inventory or, subject to s. 28, its proceeds, has priority over any other security interest in the same collateral given by the same debtor if

- (a) the PMSI in the inventory is perfected at the time the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier,
- (b) the secured party gives notice to any other secured party who has, before the registration of the PMSI, registered a financing statement containing a description that includes the same item or kind of collateral,
- (c) the notice referred to in clause (b) states that the person giving the notice expects to acquire a PMSI in inventory of the debtor, and describes the inventory by item or kind, and
- (d) the notice is given before the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is easier.

**(6)** a non-proceeds security interest in accounts given for new value has priority over a PMSI in the accounts as proceeds of inventory if a financing statement relating to the security interest in the accounts is registered before the PMSI is perfected or a financing statement relating to it is registered.

**(7)** a non-proceeds PMSI has priority over a PMSI in the same collateral as proceeds if the non-proceeds PMSI,

- (a) in the case of inventory, is perfected at the date the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier, and
- (b) in the case of collateral other than inventory, is perfected not later than 15 days after the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier.

## PROCEEDS:

**s. 28(1):** regardless of whether or not the secured party has the right to enforce the security interest against the original collateral, the secured party is also given the right to claim a security interest in proceeds received by the debtor as a result of the dealing with the original collateral.

- The SI continues in the collateral, unless SP expressly or impliedly authorized the dealing (**s. 28(1)(a)**)
- A secured party is permitted to enforce a security interest against both the original collateral as well as the proceeds held by the debtor (**s. 28(1)(b)**); however, *only* able to secure the amount of the market value of the collateral at the date of dealing, even if the obligation secured is more than the market value.
  - SP is given a security interest in D's crane. D sells the crane for \$50,000 under circumstances such that SP's security interest in the crane is not lost. B pays for the Crane by giving D a cheque for \$20,000 and a bull-dozer in trade. Three years later, the debtor defaults. The crane presently has a value of \$35,000, while the bull dozer has a value of \$25,000.
    - SP may claim a security interest in both the crane and the bull-dozer. However, SP may not recover more than \$50,000 (the market value of the crane at the time of the sale by D to B).
  - SP provides a secured loan to D for \$10,000 to buy a truck and the truck is used as collateral in the security agreement. Then, D sells the truck to B for \$7,000 (market value) and no buyer priority rule applies. D then deposits the money into his account.
    - SP can claim an SI in both the money in the account or the truck in B's possession. However, SP may not recover more than \$7,000 from, even if the value of the proceeds and the collateral together, exceeds that. The value of recovery from the original SI is locked at the market value at the point of sale.

**"Proceeds" (s. 1(1)): four requirements:**

**1) The proceeds must be "identifiable or traceable"**

- **Identifiable:** When it is factually possible to point to the particular property resulting from the dealing
  - Lost when they are mixed with other property belonging to either the debtor or third parties
    - Apply CL and Equity principles
- **Tracing:** applying the CL and equitable principles to trace the value of the asset
  - S. 1(6) of PPSA: makes it clear that the existence of a fiduciary obligation between the debtor and the secured party is not required in order to assert a claim to proceeds

**2) The proceeds must take the form of personal property**

**3) The proceeds must be derived directly or indirectly from a dealing with the original collateral or its proceeds**

- Applies to second-generation and later-generation proceeds as well
  - SP takes a security interest in D's truck. D sells the truck to B and takes an automobile in trade. D later sells the automobile to C and takes a snowmobile in trade.
    - The original collateral is the truck. It was sold to B, giving rise to proceeds in the form of an automobile (first-generation proceeds). When these proceeds are sold to C, the transaction gives rise to further proceeds in the form of a snowmobile (second-generation proceeds). Subject to the limitation in s. 28(1) and any buyer priority rules, SP could enforce the security interest against all three items (the truck in B's hands, the automobile in C's hands, and the snowmobile in D's hands)

**4) The debtor must have acquired an interest in the proceeds**

- SP takes a security interest in a truck. D sells the truck to B. B is unable to assert any of the buyer priority rules so that SP has the right to enforce the security interest against the truck. B1 later sells the truck to B2 and receives an automobile in trade.
  - SP does not have a security interest in the automobile in the hands of B1. Although the automobile was derived from a dealing with the original collateral, the automobile does not fall within the definition of proceeds because the debtor (D) never acquired an interest in it.

**Definition Also Includes:**

- Fixtures and crops
- Right to insurance payment from loss or damage to the collateral
- Payments made in discharge or redemption of assets
  - ie. cheques or other payment received when an account is paid or funds received when redeemable shares are redeemed by the issuing corporation

## PERFECTION:

**Perfection: s. 28(1)** gives the secured party a security interest in proceeds, however, in order to obtain the highest level of priority it is essential that the secured party perfect the security interest in the proceeds.

- An **Unperfected** interest in the proceeds is subordinate to the trustee in bankruptcy and transferees without knowledge (**s. 20**)
- **Three Methods of Perfection:**
  - **1) s. 28(2)(b):** proceeds fall within the original collateral description
  - **2) s. 28(2)(a):** proceeds do not fall within the collateral description, may include a proceeds description on the financing
    - **s. 37 of Regulations:** describes the manner in which the proceeds are to be described
  - **3) s. 28(2)(c):** if proceeds are in the form of money, cheques, or deposit accounts in a financial institution, the security interest is automatically perfected by registration of a financing statement in the original collateral without the need for any description of the collateral

**Temporary Perfection (s. 28(3)):** where a security interest is not perfected in accordance with s. 28(2), the secured party is given 15 days to perfect the security interest in the proceeds; where this is done, the security interest in the proceeds will be continuously perfected.

- **NOTE:** this is good against a TIB, even if the bankruptcy takes place during the 15-day period, but NOT good against bona fide buyer for purchase without knowledge (**s. 30(5)**)
- **SP takes a security interest in an excavator. SP registers a financing statement that describe the collateral by serial number. No proceeds description is included in the financing statement. On August 5, D sells the excavator to B, and receives a cheque in payment. The cheque is then used to pay for a loader which D acquires on August 10. On August 15, D makes an assignment in bankruptcy.**
  - SP's security interest in the loader is temporarily perfected for 15 days after the security interest attaches to the proceeds. The SI was temporarily perfected at the time of bankruptcy and, therefore, SP has priority over the TIB.
  - **Bankruptcy occurs on August 30. SP has not taken any steps to perfect the SI in the proceeds.**
    - SP would be subordinate to the trustee in bankruptcy under s. 20(a)
- **SP1 has a security agreement in regards to a truck. Then, SP2 takes a GSA. Then, D sells the truck and takes a motorcycle in trade.**
  - SP1 now has 15 days to perfect against the motorcycle (if s. 28(2) not followed)
- **SP takes SI in collateral. B buys collateral and gives proceeds. SP1 not perfected pursuant to s. 28(2). D goes bankrupt within 15 days.**
  - SP1 has priority over TIB as he was temporarily perfected at the date of bankruptcy
- **SP1 takes a SI in auger. B buys auger and gives proceeds (seed drill). SP1 not perfected pursuant to s. 28(2). D sells proceeds (seed drill) to another buyer with 15 days.**
  - Buyer w/out knowledge defeats temporary perfection per s. 30(5).

## PRIORITY OF PROCEEDS:

**Continuously Perfected Security Interest in Proceeds:** will generally have the same priority ranking as a SI in the original collateral—SI in proceeds is viewed as an extension of the SI in the original collateral, and therefore, given the same priority (**s. 35(2); s. 34(2), (3)**)

**Mixture of Proceeds:** PPSA priority rules only apply where the SPs have competing SIs in the same collateral (applies where proceeds are involved too); tracing requirement where it is not possible to identify the proceeds by virtue of their being mixed with other property.

- **First Proceeds Rule:** when the debtor mixes the debtor's money with that of another, the debtor is presumed to withdraw the debtor's own funds first
- **Intermediate Balance Rule:** if after applying the presumption, the account balance dips below the total amount of proceeds, the SI is adjusted downwards
  - new additions of non-proceeds funds do not accrue to the proceeds balance, and as such, cannot be accessed by the SP
- **Pro- Rata Division:** proportional division when it is not possible to apply the intermediate balance rule
  - **1a) Account has \$4000 in it. Proceeds of \$15,000 deposited into the account (19,000 total). \$2,000 is withdrawn from account (\$17,000 now).**
    - We assume that this withdrawal was taken from the non-proceeds money (the original \$4000)
  - **1b) Another \$5,000 is taken out of the account (\$12,000).**

- We assume that \$2,000 was taken from the non-proceeds money. The remaining \$3,000 would be taken out of the proceeds money in the Account (\$12,000 of proceeds are now in the account)
  - If there are no more withdrawals from the account (we can have deposits), this is where we freeze the proceeds amount—at \$12,000
- 1c) There is a deposit of \$7,000 into the Account from a source wholly unrelated to the SP and the SI. The account balance is \$19,000 now. Debtor goes bankrupt. How much is the SP entitled to as to the proceeds in the account?
  - The SP is entitled to the \$12,000 of proceeds that were in the account, although there is \$19,000 in the account deposits of non-proceeds funds do not accrue to the proceeds balance.
  - NOTE: you could go after the \$3,000 that was taken out of the proceeds account if you can trace them!
- SP1 takes a security interest in D's combine, which is registered on May 1. SP2 takes a security interest in D's tractor, which is registered on June 10. Both the tractor and the combine are sold, and the proceeds are deposited in D's bank account. After paying the creditors, only \$20,000 remains in the bank account.
  - Claims of SP1 and 2 to the bank account should not be resolved by the application of the first in time rule of s. 25(1) b/c SP1 and 2 do not have a security interest in the same collateral.
  - Each has a proceeds security interest in only a portion of the fund that represents their share of the proceeds of the original collateral. Accordingly, each SP should be entitled to a pro rata share of the fund (in proportion to the value of the original collateral deposited in the account)
- SP1 gives \$100, then SP2 gives \$300. Then Debtor withdraws \$200. The total left in the bank account is \$200. Of what amount are the SP's entitled to the proceedings remaining?
  - SP1: \$50
  - SP2: \$150
- Proceeds from SP1 are \$100. Proceeds from SP2 are \$300. The debtor withdraws \$200. The Proceeds from SP1 after withdrawal are \$200. What happens?
  - **Two Options:**
    - **1) Lowest Intermediate Balance Rule:** apply this approach
      - Total in the bank account is \$400
        - SP1 entitled to \$250; SP2 entitled to \$150.
    - **2) Pair Passu Ex Post Facto Approach:**
      - Total in the bank account: \$400
        - SP1 entitled to \$200; SP2 entitled to \$200
      - NOTE: when you can't determine who put in what, or it is too expensive to determine, then apply this second approach—ONLY when evidentiary uncertainty

## SPECIAL PRIORITY RULES:

Some of the provisions of the PPSA provide a different priority outcome if the SI is in proceeds, rather than original collateral:

**Non-Proceeds SI in Accounts (Receivables) vs PMSI in Accounts as Proceeds:**

s. 34(6): where a competition arises between an account financier and a SP who claims a security interest in the proceeds of inventory

- SP1 takes a SI in D's accounts and registers a financing statement describing the collateral as accounts on February 10. SP2 takes a PMSI in D's inventory and registers on March 15. Inventory is sold giving rise to accounts payable to D.
  - In the absence of this special rule, SP2's PMSI in the accounts as proceeds would prevail over SP1's security interest in the accounts as original collateral BUT
  - S. 34(6) alters this by giving priority to SP1 provided that SP1 was first to register
    - This ensures that an accounts financier's security interest is not undercut by a subsequent inventory financier
  - NOTE: Ontario and Atlantic Provinces adopted opposing rule: inventory financier gives notice to the bank of its intention to take an SI in proceeds

**Non-Proceeds PMSI vs Proceeds PMSI:**

s. 34(7): covers a competition between two PMSIs, one of which is in proceeds. Non-proceeds PMSI has priority over a PMSI in the proceeds of the original collateral, if the non-proceeds PMSI is perfected within certain time frames.

(a): Inventory:

if non-proceeds PMSI is perfected at the date of the debtor or another person at the request of the D, obtains possession of the collateral, whichever is earlier

(b): Collateral Other than Inventory:

perfected within 15-days after the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier

- **SP1 takes a PMSI in a fork lift acquired by D. D buys a truck from SP2 under a secured instalment purchase agreement and gives SP2 the fork-lift in trade.**
  - Both SP1 and SP2 have a PMSI in the truck. SP1 is claiming a PMSI interest in the truck as proceeds arising out of the sale of the fork-lift. SP2 is claiming a PMSI in the truck as original collateral.
  - S. 34(7) ensures that SP2's non-proceeds interest is given priority over SP1's proceeds interest

## CASE LAW:

### ***Universal CIT Credit Corporation v Farmers Bank of Portageville (1973 US)***

[application of intermediate balance rule]

**Facts:** D ran car dealership and was receiving floor financing from CIT. CIT cancelled their floor financing and this pissed off the debtor. D had proceeds from the sale of six cars, which CIT had financed and had not remitted this balance to them yet. He went to see FB and wanted to ensure they got paid as he knew it would be going out of business. He directed the bank to take \$12,000 for themselves before CIT got it.

**Issue:** How much can CIT now trace to the bank account?

**Held:** Apply Intermediate Balance Rule. Comingled accounts do not render the proceeds unidentifiable.

**Ratio: When tracing comingled funds, it is presumed that any payments made were from funds in which another did not have a legally recognized interest (Intermediate Balance Rule). Where a bank account has both non-proceeds amounts (personal funds) and proceeds amounts, the SP cannot enforce an equitable lien upon the non-proceeds amounts greater than the lowest intermediate balance of the deposit.**

### ***Boughner v Greyhawk Equity Partners Limited Partnership (Millenium) (2012 ONSC):***

**Ratio: Apply the Lowest Intermediate Balance Rule unless there is some reason that you cannot apply it.**

### ***Agricultural Credit Corp of Saskatchewan v Pettyjohn (1991 SKCA):***

[tracing of proceeds under PMSI; application of "Functional Equivalent Rule"]

**Facts:** D's originally applied for a loan with ACCS for the purpose of buying 70 cows. The bank financed the acquisition of the ordinary collateral and took a PMSI in the original cattle. Before the monies are extended by the bank, D's take out a bridge loan with which they purchase the cattle. However, the original cattle are being sold by P and at the same time the specialty breed is being acquired. The bank wants to claim a PMSI in the Watusi Cattle as proceeds so it can claim that the PMSI it originally had in the ordinary cattle is retained in the Watusi Cattle.

**Issue:** Did ACCS have a PMSI in the original cattle? If so, can ACCS trace the PMSI to the new breed of cattle?

**Ratio: Where an additional financier is used as a bridge financier, and the original financier then pays off the bridge financier, the original financier can claim a PMSI. Applies Functional Equivalence Rule: if the collateral proceeds are functionally equivalent in nature to the original collateral, we will treat it as proceeds regardless of the sequence of events.**

**Commentary:** Not sure if applicable in Alberta at this point

### ***Transamerica Commercial Finance Corp Canada v Royal Bank of Canada (1990 SKCA):***

[accounts financier takes priority over PMSI under s. 34(6) only where the accounts are accounts receivable; not cash deposit accounts]

**Facts:** RBC had perfected SI in all of R's present and after acquired personal property from June 1982. R had an account registered with the bank. T had a PMSI with R which was perfected in April of 1988, per s. 34(3). R made several dealings with the collateral and had received payments, which were placed in the bank account. R went bankrupt.

**Issue:** Who takes priority as between the inventory financier who holds the PMSI and the bank, which holds the GSA?

**Held:** Inventory Financier takes priority.

**Ratio: s. 34(6) does not allow a bank to protect their own debt owed to the dealer, in a bank account. S. 34(6) is designed to cover accounts generated by sale, where a third party rules the account.**