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Although great care has been taken to prepare these notes there may be errors and omissions. These notes are no substitute for attending lectures and scrutinizing the suggested and required readings. Enjoy.

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Title Under the Sale of Goods Act

This *Act* deals with 'title' to goods in the context of a sale of goods. It is important to distinguish between a property right, which is title to the goods, and a mere personal right, which may be possession of the goods. The person who has title to the goods, whether s/he has possession or not, has rights over the goods which are important and valuable.

Title

Section 1 – Definitions

"buyer" means the person who buys or agrees to buy goods;

"contract of sale" includes an agreement to sell as well as a sale;

"delivery" means the voluntary transfer of possession from one person to another;

"sale" includes a bargain and sale as well as a sale and delivery;

"seller" means a person who sells or agrees to sell goods;

"specific goods" means the goods identified and agreed upon at the time the contract of sale is made;

Section 2 – Sale and Agreement to Sell

2.(1) A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in the goods to the buyer for a money consideration, called the price, and there may be a contract of sale between one part owner and another.

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

(4) An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred.

In other words, a contract of sale is a sale where the seller transfers or agrees to transfer property for consideration – subsection 2(1). Where the transfer is to take place at a future time or subject to some condition, it is called an agreement to sell – subsection 2(3). Finally, an agreement to sell becomes a sale when the time elapses or the condition is met – subsection 2(4).

Section 6 – Subject of the Contract

6.(1) The goods that form the subject of a contract of sale may be either existing goods owned or possessed by the seller or goods to be manufactured or acquired by the seller after the making of the contract of sale, in this Act called "future goods".

(3) Where by a contract of sale the seller purports to effect a present sale of future goods, the contract operates as an agreement to sell the goods.

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In other words, the goods that forum the subject of the contract may be either existing goods or goods to be manufactured or acquired by the seller – subsection 6(1). Where the sale is for a future good, the contract operates as an agreement to sell – subsection 6(3).

Section 17 – Goods Must be Ascertained

> **17.** Where there is a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer until the goods are ascertained.

Title to the goods cannot pass from the seller to the buyer until the goods are ascertained.

Section 18 – Title Passes When Intended To

> **18.**(1) Where there is a contract for the sale of specific or ascertained goods, the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred.
>
> (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.

Where the intention of the parties cannot be determined by the contract, then turn to section 19 of the Act.

Section 19 – Rules for Ascertaining Intention

> Unless a different intention appears, the following are rules for ascertaining the intention of the parties as to the time at which the property in the goods is to pass to the buyer:
> **Rule 1** – Where there is an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer when the contract is made and it is immaterial whether the time of payment or the time of delivery or both is postponed.
> **Rule 2** – Goods and the seller is bound to do something to the goods for the purpose of putting them into a deliverable state, the property does not pass until such thing is done and the buyer has notice thereof.
> **Rule 3** – Where there is a contract for the sale of specific goods in a deliverable state but the seller is bound to weigh, measure, test or do some other act or thing with reference to the goods for the purpose of ascertaining the price, the property does not pass until such act or thing is done and the buyer has notice thereof
> **Rule 4** – When goods are delivered to the buyer on approval or "on sale or return" or other similar terms, the property therein passes to the buyer;
> (i) when the buyer signifies approval or acceptance to the seller or does any other act adopting the transaction;
> (ii) if the buyer does not signify approval or without giving notice of rejection, then if a time has been fixed for the return of the goods, on the expiration of such time, and, if no time has been fixed, on the expiration of a reasonable time, and what is a reasonable time is a question of fact.
> **Rule 5** - (i) Where there is a contract for the sale of unascertained or future goods by description and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer, or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer, and such assent may be expressed or implied and may be given either before or after the appropriation is made.
>
> (ii) Where in pursuance of the contract the seller delivers the goods to the buyer or to a carrier not) for the purpose of transmission to the buyer and does not reserve the right of disposal, the seller shall be deemed to have unconditionally appropriated the goods to the contract

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A sale technically connotes the fact that title has passed. It is very important to know where title lies at any given time. Before title passes the seller has to have ownership of the goods – subsection 6(1). Suppose a seller is going to manufacture a product to sell, s/he owns the parts to make a tractor, when is title going to pass? The title cannot pass until the tractor is identifiable to the contract – in other words, when the goods are ascertained.

Effects of the Passage of Title

Section 21 – Risk Passes with Property

> **21.** Unless otherwise agreed, the goods remain at the seller's risk until the property therein is transferred to the buyer, but, when the property therein is transferred to the buyer, the goods are at the buyer's risk whether delivery has been made or not, but,
>
> (a) where delivery has been delayed through the fault of either the buyer or seller, the goods are at the risk of the party in fault as regards any loss that might not have occurred but for such fault; and
>
> (b) nothing in this section affects the duties or the goods of the other party.

Subsection 47(1) – Seller may Maintain Action for Price

> **47.(1)** Where, under a contract of sale, the property in the goods has passed to the buyer and the buyer wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may maintain an action against the buyer for the price of the goods.

Subsection 12(3) – Right to Claim Damages

> **12.(3)** Where a contract of sale is not severable and the buyer has accepted the goods or part thereof, or where the contract is for specific goods the property in which has passed to the buyer, the breach of any condition to be fulfilled by the seller can only be treated as a breach of warranty and not as a ground for rejecting the goods and treating the contract as repudiated, unless there is a term of the contract, express or implied, to that effect.

Summary

Being able to identify who has what property rights and when will help you decide when you have a cause of action and where the risk lies.

In order for title to pass you require two things:

1. The goods must be *ascertained*; and,
2. The seller must have something to sell – some *interest* in the ascertained goods.

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The Nemo Dat Rule

The Basic Rule

Nemo Dat Quod Habet – A person cannot transfer a title that she or he does not have, but can only transfer an interest that she or he has. If a person attempts to transfer title s/he does not have, generally the person who owned the goods before the transaction occurred will win. However, there is a presumption that the person who possesses the good has title in the good unless another can show she or he has better title in the good. There are also a number of exceptions to the *nemo dat* rule.

Exceptions to the *nemo dat* rule carve out holes in the foundational principle based upon fault considerations of estoppel, entrustment and the desirability of protecting good faith purchasers of the collateral in the interest of market efficacy and the security of the transaction.

Exceptions to the Nemo Dat Rule

1. Section 22 – Conduct Precluding Owner

> **22.** Subject to this Act, where goods are sold by a person who is not the owner thereof and who does not sell them under the authority or with the consent of the owner, the buyer acquires no better title to the goods than the seller had, unless the owner of the goods is by conduct precluded from denying the seller's authority to sell but nothing in this Act affects,

The exception enunciated in this section is based on agency by estoppel. There are three elements:
1. A representation is made;
2. The representation is relied upon; and,
3. The reliance is to the detriment of the individual relying upon the representation.

There are two ways that an owner can be precluded from claiming title:
1. Where the rogue has *Apparent Authority* – the true owner has in some way held the rogue out as having some authority; or,
2. Where the rogue has *Ostensible Authority* – the true owner has in some way clothed the rogue with the badges of ownership, which estop the true owner from denying the rogue's authority to sell (more than mere possession, such as being in possession of the good and it's title document)

2. Subsections 22(a) and (b) – Factors Act, Common Law and Other Statutes

> **22.(a)** the Factors Act or any enactment enabling the apparent owner of goods to dispose of them as if he, she or it were the true owner thereof

If you find a statute that provides that the person in possession can transfer good title, then you have an exception to the *nemo dat* rule.

The *Factors Act* allows those in possession to transfer good title under the follow circumstances:
1. The unauthorized agent must be a mercantile agent;
2. The delivery by the true owner to the mercantile agent must have been a delivery to the mercantile agent in his capacity as a mercantile agent;
3. The sale by the mercantile agent must be in the ordinary course of business;
4. The buyer seeking the exception must have purchased in good faith without notice (bona fide purchaser for value or good faith purchaser)

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> **22.(b)** the validity of any contract of sale under any special common law or statutory power of sale or under the order of a court of competent jurisdiction.

There are a number of other statutes, such as the *Inkeeper's Act*, which grant the authority upon someone to sell, without the granting of title, to another buyer. For instance, an individual who has left an item in a room after underpaying or not paying allows the innkeeper to then sell the good to satisfy the debt. You simply look to various statutes for exceptions and property law for common law exceptions.

3. Section 24 – Sale Under Voidable Title

> **24.** When the seller of goods has a voidable title thereto but the seller's title has not been avoided at the time of the sale, the buyer acquires a good title to the goods, if they are bought in good faith and without notice of the seller's defective title.

If a seller sells to a good faith purchaser a voidable title before the title has been avoided, the purchaser acquires good title. Two issues:

1. You must be able to distinguish between a void and voidable title; and,
2. The good faith purchaser must purchase before the title is avoided.

Where the seller has a voidable title, but the seller's title has not been avoided at the time of the sale to the good faith purchaser for value, then the good faith purchaser for value acquires good title. In other words, the title must be avoided before the goods is transferred to a good faith purchaser.

4. Subsection 25(1) – Seller in Possession

> **25.(1)** Where a person having sold goods continues or is in possession of the goods or of the documents of title to the goods, the delivery or transfer by that person, or by a mercantile agent acting for that person, of the goods or documents of title under a sale, pledge or other disposition thereof to a person receiving the goods or documents of title in good faith and without notice of the previous sale, has the same effect as if the person making the delivery or transfer were expressly authorized by the owner of the goods to make the delivery or transfer.

In other words, if the seller remains in possession of the goods and sells them to some other good faith purchaser for value, the good faith purchaser will take the goods free and clear. It is important to consider where the title was when the seller purported to sell them.

Step One – look to the intention of the parties, if the intention cannot be determined
Step Two – look to the rules set out in section 19

If title has yet to pass to the buyer, then you do not need an exception to the *nemo dat* rule because the seller still had title to pass. However, if title had passed to the buyer the subsection 25(1) exception will apply and the good faith purchaser gets title. This is an exception because there was an entrustment of possession by the first purchaser to a person who had been the seller of the goods (more than a mere entrustment).

The first purchaser may protect him/herself from the subsection 25(1) exception by ensuring that any potential purchaser's have notice of the previous sale to him/her. Clearly posting a sign or tagging the equipment can do this. There still is a chance that the rogue seller would remove the sign or tag, in which case a newspaper advertisement of the sale or the employment of a security guard would be more effective.

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6. Section 25(2) – Buyer in Possession

> **25.(2)** Where a person having bought or agreed to buy goods obtains, with the consent of the seller, possession of the goods or the documents of title to the goods, the delivery or transfer by that person, or by a mercantile agent acting for that person, of the goods or documents of title, under a sale, pledge or other disposition thereof to a person receiving the goods or documents of title in good faith and without notice of any lien or other right of the original seller in respect of the goods, has the same effect as if the person making the delivery or transfer were a mercantile agent in possession of the goods or documents of title with the consent of the owner.

This provision applies where possession passes to the buyer, but seller still has title or some aspect of the title. The buyer then sells the goods to a good faith purchaser. This *does not* apply to conditional sales contracts, such as where the contract stipulates that title does not pass until the purchase price is paid. There are few practical situations such as where the buyer misrepresents to the seller such that the buyer

Summary

Thus far we have looked at the idea of title and the *Sale of Goods Act*. Goods were taken as an example and the concepts were applied: title cannot pass in goods until those goods are identified with the contract. The process of identification involves statutory analysis. Were the goods specific goods? Were the goods ascertained?

In addition, there are statutory rules that provide that goods can be ascertained, but if the seller does not have any property rights in those goods, then no property will pass until the seller has some property that can pass. In other words, the seller cannot sell what he does not have, which is known as the *nemo dat* rule. However, there are a number of qualifications and exceptions to this rule. A seller sometimes can transfer more than he or she has.

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Personal Property Security Legislation

Structure of the PPSA

Summary of Parts

The PPSA is broken down into seven parts:

Part I – Application and Conflict of Laws
Part II – Validity of security agreements and rights of parties
Part III – Perfection and Priorities
Part IV – Registration
Part V – Default Rights and Remedies
Part VI – Miscellaneous
Part VII – Application, Transition, Amendments

Section 1 – Definitions

> "security interest" means an interest in personal property that secures payment or performance of an obligation, and includes, whether or not the interest secures payment or performance of an obligation, the interest of a transferee of an account or chattel paper;
>
> "security agreement" means an agreement that creates or provides for a security interest and includes a document evidencing a security interest
>
> "goods" means tangible personal property other than chattel paper, documents of title, instruments, money and securities, and includes fixtures, growing crops, the unborn young of animals, timber to be cut, and minerals and hydrocarbons to be extracted;
>
> "collateral" means personal property that is subject to a security interest;
>
> "debtor" means a person who owes payment or other performance of the obligation secured, whether or not the person owns or has rights in the collateral, and includes,
> (a) an assignor of an account or chattel paper, and
> (b) a transferee of or successor to a debtor's interest in collateral
>
> "secured party" means a person who holds a security interest for the person's own benefit or for the benefit of any other person and includes a trustee where the holders of obligations issued, guaranteed or provided for under a security agreement are represented by a trustee as the holder of the security interest and for the purposes of sections 17, 59 to 64, 66 and 67 includes a receiver or receiver and manager;
>
> "personal property" means chattel paper, documents of title, goods, instruments, intangibles, money and securities and includes fixtures but does not include building materials that have been affixed to real property;
>
> "value" means any consideration sufficient to support a simple contract and includes an antecedent debt or liability

A security interest is a property right that is created by a security agreement in collateral. The person who receives the security interest is called the secured party while the person who gives the security interest is called a debtor.

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Classifying Collateral

Recall that collateral means personal property that is subject to a security interest. Collateral is always classified based on its use in the hands of the debtor.

Collateral may be broken down into the following classes:

1. **Fixtures**
2. **Goods** – divided into three categories:
    a. *Consumer Goods* – used for personal purposes;
    b. *Inventory* – goods held for sale or lease, raw materials, or materials consumed in business; and,
    c. *Equipment* – any good that is not a consumer good or inventory
3. **Chattel Paper** – One or more pieces of paper that evidence (1) a monetary obligation and (2) a security interest in specific goods that go along with the obligation;
4. **Instrument** – this type of collateral includes:
    a. *Bill of Exchange* – any bill, note, or cheque within the meaning of the *Bills of Exchange Act*;
    b. *Letter of Credit*;
5. **Security** – a right in an enterprise;
6. **Document of Title** – the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers. There are two main types:
    a. *Bill of Lading* – evidences a shipping arrangement where the party name *prima facie* has title to the goods and is entitled to the goods;
    b. *Warehouse Receipts*
7. **Intangible** – all personal property that are not goods, chattel paper, document of title, instruments etc.,

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Scope of the PPSA

The *Act* is aimed at curbing the potential mischievous use the debtor, who has given a security interest in the collateral, may make of the collateral. The opportunity for mischief arises because of the separation of title and possession. People dealing with the debtor must have some way of knowing what the debtor's interests are. Thus, the primary purpose of the *Act* is to overcome the mischief that may arise as a result of the separation of title form possession. The *PPSA* tells secured parties what they must do in order to protect their security interests.

Application

Section 2 – General Application of the Act

2. Subject to subsection 4 (1), this Act applies to,

(a) every transaction without regard to its form and without regard to the person who has title to the collateral that in substance creates a security interest including, without limiting the foregoing,
   (i) a chattel mortgage, conditional sale, equipment trust, debenture, floating charge, pledge, trust indenture or trust receipt, and
   (ii) an assignment, lease or consignment that secures payment or performance of an obligation; and

(b) a transfer of an account or chattel paper even though the transfer may not secure payment or performance of an obligation.

Leases

Leases result in a clear separation of title and possession. A true lease is not caught under the *Act,* but a security lease does fall within its scope. How do we determine which leases are true leases and which leases are security leases?

Security Leases v. True Leases

A security lease is intended to secure a credit obligation. Typically, the security lease is disguised as a conditional sale because the payment under the lease amount to the purchase price of the goods plus interest. At the end of the lease there is often an option to purchase the goods for a nominal fee. A true lease will never allow the lessee to be the owner of the property. A security lease must be perfected by registration.

Crop & Soil Service v. Oxford Leaseway (2000) ON CA

Facts	Holding	Ratio
o A car was leased for a fixed period where at the end of the period the lessee had the option of purchasing the car for a fixed value o At the end of the period if the car is returned and sold by the dealer, the lessor has to compensate for any deficiency in sale or receive the surplus	o The lessee is put to the risk of compensating for an increase or decrease in value to the lessor	o A security interest is created when the property in question has a predetermined fixed value at the end of the lease and the lessee is entitled to the profits or responsible for a deficiency upon the sale of the property

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Another very common lease is the financing lease. A financing company purchases the machinery from a manufacturer and then finances it to a businessperson. Is the financing lease a security lease or a true lease? Even if there is no option to purchase, one could still say that the lease is a device to ensure payment or performance of an obligation.

Adelaide Capital Corp. v. Integrated Transportation Finance Inc. (1994) Gen Div

Facts	Holding	Ratio
○ Not Done	○ This case involves the advancing of funds by a financing institution to facilitate the acquisition of a large number of vehicles or pieces of equipment – creditors who are truly in the business of financing transaction should be required to indicate the collateral over which they are claiming a security interest	○ The test is whether the transaction, as a whole, in substance creates a security interest, and, in the context of a lease instrument, whether the lease in one "that secures payment or performance of an obligation"

The mere registration of the financing statement does not create a security interest.

Paragraph 46(5)(b) – Effect of Registration

> **46.(5)** Registration of a financing statement or financing change statement,
> (b) does not create a presumption that this Act applies to the transaction to which the registration relates

Consignments

In the consignment relationship, the consignor still owns the goods, but the consignee has the authority of the consignor to sell the goods. The relationship is phrased in terms of agency. While the consignee is in possession, you have a separation of possession and title. A true consignment arrangement exists where a supplier furnishes supplies to a trader on the understanding that the trader will not be liable to pay for the goods unless s/he opt to buy them. The trader is deemed to exercise the option to buy the goods by re-selling them. If the trader cannot find a buyer, s/he will be entitled to return the goods. In other words, the consignor may take the goods back because title never passed to the consignee. However, if you take a consignment agreement and add a clause directing that upon the happening of some condition the consignee must buy the goods, then the consignment may be caught under the *PPSA* because it creates, in substance, a security interest. The trader, in some fashion, has an obligation to pay for the goods.

Trusts

Suppose A supplies cars to B and B holds those cars in trust. B can sell them, but any proceeds of the sale are to be held in trust for A. Trust language has here been used to create a security interest. The property right called a trust (equitable interest) would be characterized as a security interest. Generally, trusts fall outside the scope of the *PPSA* and the beneficiary will take the benefit.

Re Skyridge Holidays Inc.

Facts	Holding	Ratio
○ A deposit was put down for plane tickets and the travel agency went bankrupt	○ No security interest in the deposit ○ A trust interest is a security interest only if the purpose is the secure payment or performance of an obligation	○ A trust interest is a security interest only if the purpose is to secure payment or performance of an obligation

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Exceptions

Section 4 – Non-Application of the Act

4.(1) This Act does not apply,

(a) to a lien given by statute or rule of law, except as provided in subclause 20 (1) (a) (i) or section 31;
(b) to a deemed trust arising under any Act, except as provided in subsection 30 (7);
(c) to a transfer of an interest or claim in or under any policy of insurance or contract of annuity;
(d) to a transaction under the Pawnbrokers Act;
(e) to the creation or assignment of an interest in real property, including a mortgage, charge or lease of real property, other than
  (i) an interest in a fixture, or
  (ii) an assignment of a right to payment under a mortgage, charge or lease where the assignment does not convey or transfer the assignor's interest in the real property;
(f) to an assignment for the general benefit of creditors to which the Assignments and Preferences Act applies;
(g) to a sale of accounts or chattel paper as part of a transaction to which the Bulk Sales Act applies;
(h) to an assignment of accounts made solely to facilitate the collection of accounts for the assignor; or
(i) to an assignment of an unearned right to payment to an assignee who is to perform the assignor's obligations under the contract.

Rights under *Sale of Goods Act*

(2) The rights of buyers and sellers under subsection 20 (2) and sections 39, 40, 41 and 43 of the *Sale of Goods Act* are not affected by this Act

Subclause (e) is probably the most important one and has a bit of a history. Does the assignment of a mortgage get covered under the Act? Traditionally, we would respond in the negative. While a mortgage is money owing, it is money owing for real and not personal property. However, a real estate mortgage really has two interests: an interest in real estate and a right to get a stream of payments. Insofar as it is a right to a stream of payments we would characterize it as an account and, thus, covered under the Act. If an assignee to a mortgage does not file a financing statement in the Personal Property Registry they would then be vulnerable to others. The Court of Appeal has considered this characterization and decided that where the real interest and account are taken together on a mortgage, the classification of the interest is in land. This is why (e) is relevant, because if the interests are separated then the account interest will be covered – it is not uncommon to have an assignment of only the stream of payments on a mortgage separately from the interest in the real property, in which case the Act will apply.

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Validity and Attachment

Validity of the Security Agreement

Section 9 – Effectiveness of the Security Agreement

> **9.(1)** Except as otherwise provided by this or any other Act, a security agreement is effective according to its terms between the parties to it and against third parties.
>
> **(2)** A security agreement is not unenforceable against a third party by reason only of a defect, irregularity, omission or error therein or in the execution thereof unless the third party is actually misled by the defect, irregularity, omission or error.
>
> **(3)** Without restricting the generality of subsection (2), the failure to describe some of the collateral in a security agreement does not affect the effectiveness of the security agreement with respect to the collateral that is described.

The security agreement is a type of contract whose purpose it is to give a security interest and define the personal property over which one has a security interest. We want some objective evidence in writing whereby at a later time a third party can verify whether there is a security interest on a particular piece of collateral. A secured party will likely file a document called a 'financing statement' in a public registry, which can be searched by third parties as a matter of right. We run into problems in specifically drafted documents.

In order to have a security interest the agreement must:

1. Grant a security interest; and,
2. Identify some collateral.

Enforceability of the Security Agreement

Subsection 9(1) provides that the security agreement is effective according to its terms between the parties and against third parties. However, section 11 qualifies subsection 9(1) and provides that in order to be enforceable against third parties the security interest must have 'attached'.

Subsection 11(1) – Attachment Required

> **11.**(1) A security interest is not enforceable against a third party unless it has attached.

When Security Interest Attaches

Subsection 11(2) – When Interest Attaches

> **11**.(2) A security interest, including a security interest in the nature of a floating charge, attaches when,
>
> (a) the secured party or a person on behalf of the secured party other than the debtor or the debtor's agent obtains possession of the collateral or when the debtor signs a security agreement that contains a description of the collateral sufficient to enable it to be identified;
>
> (b) value is given; and

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(c) the debtor has rights in the collateral, unless the parties have agreed to postpone the time for attachment, in which case the security interest attaches at the agreed time.

356447 British Columbia Ltd. v. CIBC (1998) BC CA

Facts	Holding	Ratio
o The agreement between the parties provided that the numbered company promised to "pay all funds derived from the Georgian Hospitality Joint Venture"	o There is a difference between a promise to do something and a transfer o A promise to do something takes effect in equity at the present time – giving an equitable title o An assignment created in equity is sufficient to create a valid security agreement	o An assignment created at equity is a security interest for the purposes of the PPSA and is properly registrable under the Act

Guntel v. *Kocian* – "An acknowledgment by a debtor that he owed his creditor a stated sum plus interest for a 1979 GMC truck, with serial number specified, was sufficient to satisfy the requirements of the Act in the particular circumstances of that case."

Atlas Industries v. Federal Business Development Bank (1983) Sask QB

Facts	Holding	Ratio
o Plaintiff sold goods on credit and shipped to the defendant o Plaintiff learned that the buyer was going bankrupt so he stamped on the purchase orders, "title in goods remains with the seller until paid" o Buyer goes bankrupt and the plaintiff sends forms to the trustee in bankruptcy claiming a security interest	o The intention of the parties was merely to indicate receipt of the goods and not to enter into a security agreement o The documents did not comply with the writing requirements of the Act and, therefore, cannot create a valid security interest	o The documents purporting to create a security agreement ought to comply with the writing requirements of the Act

If an individual gives another a security interest in a chattel that s/he presently owns, then we have a security interest that very specifically defines the collateral. However, consider where an individual with a large shop gives a bank a security interest in all presently owned and after-acquired inventory, equipment, and accounts. By the nature of long-term financing, the security agreement cannot specifically define ascertained goods. Collateral may be described in the financing statement as 'consumer goods', 'inventory', 'equipment', 'accounts', or 'other'. These classifications are not much help to third parties. Problems may arise because only the financing statement are filed and can be searched as a matter of right. Section 18 of the Act establishes a procedure where a third party can gain access to information in the relevant documents.

Curative Provisions

Subsection 9(2) – Curing a Security Agreement

9.(2) A security agreement is not unenforceable against a third party by reason only of a defect, irregularity, omission or error therein or in the execution thereof unless the third party is actually misled by the defect, irregularity, omission or error.

An error in a security agreement is not fatal unless a third party was actually misled by the error (subjective test). If the error is fatal it will render the security agreement unenforceable against third parties.

Re Ayerst and Ayerst (1984) ON CA

Facts	Holding	Ratio
○ It was mutually intended that a schedule marked as "A" would be attached but was omitted by error	○ The court applied 9(2) – the schedule was intended to be attached, but was not due to error and would be cured unless one of the parties was misled	○ Subsection 9(2) can be applied to cure simple errors and omissions that do not mislead the parties in the *security agreement* ○ An error in a security agreement is not fatal unless a third party was actually misled

Note: subsection 9(2) ought not be confused with subsection 46(4). The curative provisions in subsection 9(2) apply the to security agreement while the curative provisions in subsection 46(4) apply to errors in the registration (financing statement).

Attachment

Section 11 -

(1) A security interest is not enforceable against a third party unless it has attached

(2) A security interest, including a security interest in the nature of a floating charge attaches when,

a. The secured party or a person on behalf of the secured party other than the debtor or the debtor's agent obtains possession of the collateral or when the debtor signs a security agreement that contains a description of the collateral sufficient to enable it to be identified;

b. Value is given; and

c. The debtor has rights in the collateral, unless the parties have agreed to postpone the time for attachment, in which case the security interest attaches at the agreed time.

An unattached security interest does not bind third parties, but it can bind the parties to it a valid contract. Even at a time where it may be said that the security interest does not attach, it will still work as a contract as between the parties. In that case, it will still be subject to the law of contract. Where a contract creates a valid security interest, however, it will then bind third parties and become a property right. An attached security interest is not the highest form of enforceability – perfection is the highest form.

For a security interest to attach there are three requirements:

1. *Written security agreement or debtor's possession of collateral* – The secured party or a person on behalf of a secured party obtains possession of the collateral or where the debtor signs a security agreement sufficient to identify the collateral (looking for some objective evidence that a third party can see that a security interest has been created – some tangible evidence of attachment);
2. *Value* – the secured party must give value (any consideration sufficient to support a simple contract and includes an antecedent debt or liability);
3. *Debtor Rights in Collateral* – the debtor must have rights in the collateral

What if an individual is owed money, but it is not due and payable at the present time. That individual hears rumors about the debtor and months later asks him/her to secure the loan. The individual agrees. What new consideration was given for the new security interest? Past consideration is not good

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consideration – you cannot have an attached security interest if the secured party does not give value. However, the definition of value plugs that up – an antecedent debt gives 'value':

> "value" means any consideration sufficient to support a simple contract and includes an antecedent debt or liability

Hypothetical – Sally's Automobile

An individual cannot give a security interest in goods that another owns without having title at all. If an interest in the goods is never had, the security interest will not attach. Be wary, however, of the exceptions to the *nemo dat* rule. The security interest can only attach when the individual gains some interest in the collateral – unless an exception is found to the *nemo dat* rule, the interest that attaches is only the interest that is actually had.

Kinetics Tech. International v. Fourth National Bank of Tulsa (1983) 10th Circuit

Facts	Holding	Ratio
o KTI owns some furnace economizers and wanted some work done on them (KTI goods) o KTI delivered the KTI goods to OHT, which would work on them and also add certain things to the KIT goods – bailed for the purposes of repair o KTI pre-paid for the work o Bank of Tulsa had a security interest in all of OHT's property o OHT defaults and the bank comes in as a receiver and takes possession of all goods on premises and sells the goods o KTI brings an action for conversion	o Issue: Did the Bank have an attached security interest to the KTI goods? o In order for the Bank to get an attached security interest, OHT would have to have an interest in those goods o OHT only had possession of the goods o KTI should have registered an interest in the property as a buyer – this additional step thoroughly advances the Code policy of providing notice and certainty to inventory lenders o Stewart says this reasoning is incorrect/bad	o Only where the debtor has some rights in the collateral will a security interest given by the debtor bind the owner of the collateral

All we really have in this case is a bailment that has ended – the bank's security interest only attached to the OHT interest – OHT not having an interest in the KTI goods. In order to find an interest in the collateral the debtor must have an interest and the secured party can only obtain the interest that the debtor has. Therefore, the bank had no interest in the KTI goods.

You cannot get a security interest until it attaches. There are a number of possible reasons that the security interest does not attach:

1. Value is not given;
2. A security agreement is not signed by the debtor; and/or,
3. The debtor does not have rights in the collateral.

Even if an individual undertakes a perfecting act, s/he cannot reach the perfecting state until the security interest attaches. For instance, filing a financing statement without attachment is not helpful.

"Floating Charge" – a creation in Anglo-Canadian law, which provides that a secured party may have an interest in the assets and undertakings of a debtor upon soliciting notice to that party. An argument was put forward in the 1970s that floating charge language indicated an intention to postpone attachment. The

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case law decided that floating charge language did not indicate such an intention. A floating charge may attach as section 11 indicates that it should. The problem with the floating charge is that when the secured party gave permission to deal 'in the ordinary course of business' it is not known what is meant by the term 'ordinary course of business'.

After-Acquired Property

Section 12(1) of the Act provides:

> "A security agreement may cover after-acquired property"

After-acquired property can be included in a security agreement. Suppose you have a signed security agreement with an after-acquired property clause and a financing statement is filed. Value has properly been given. The debtor then acquires a new piece of equipment. When would the security interest in the machine have attached? The security interest would attach when the equipment is acquired because it is only at that point when the debtor has rights in the collateral. Remember, an interest can only attach when the debtor has rights in the collateral. When would the security interest perfect? A security interest cannot perfect until there has been some attachment. Therefore, perfection can only occur after an attachment, which, in this case, is when the debtor obtains rights in the collateral.

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Perfection

A secured party can only reach the highest degree of enforceability once s/he reaches a perfected state. There are three methods of getting to the perfected state:

1. Perfection by registration – File a proper financing statement;
2. Perfection by possession – possession by the secured party of the collateral; and,
3. Automatic temporary perfection – there are a few provisions in the Act that provide temporary perfection – consider section 24

1. Perfection by Possession

Section 22 provides:

> Possession or repossession of the collateral by the secured party, or on the secured party's behalf by a person other than the debtor or the debtor's agent, perfects a security interest in (a)-(f), but only while it is actually held as collateral.

There have been in the past some issues with possession as the perfecting act.

Re Raymond Darzinskas (1981) SCC

Facts	Holding	Ratio
o There was a default on some machinery o The secured party sent in a bailiff who seized the equipment o A farmer, after the equipment was seized, tried to finance the machine o The farmer went bankrupt	o If a secured party does not have a perfected interest at the date of bankruptcy, s/he is an unsecured creditor o Issue: At the date of bankruptcy was the secured party perfected by possession o The bailiff had constructive possession, but it was not maintained – section 22 requires actual possession to be taken in order to perfect the interest and provide notice to all interested parties that possession is taken	o Section 22 requires actual possession in order to prefect the security interest – especially where the security interest is not perfected by registration

Sperry v. CIBC (1985) ON CA

Facts	Holding	Ratio
o Two parties had a security interest in the same collateral o Both parties had filed financing statements, but both had lapsed o On March 14, CIBC appointed a receiver as per their security agreement who took possession o Clause in agreement: Any such receiver shall be deemed to be the agent of the undersigned	o Issue: Was the receiver's action a perfecting action by possession? o The possession required by the Act must be unequivocal – it cannot be by the debtor's agent o The mere decision to realize falls short of realizing on the security	o The possession required by the Act must be unequivocal – it cannot be by the debtor's agent

The last phrase in the provision provides "but only while it is actually held as collateral". What is meant by this provision?

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2. Perfection by Registration

In order to perfect by registration a party must file a financing statement. This is provided at section 45 of the Act:

> "In order to perfect a security interest by registration under this Act, a financing statement shall be registered"

What information is required in the financing statement in order to be valid? It must identify the debtor and the collateral. What is the purpose of filing the financing statement? Some argued that it is to allow third parties to get notice of the security interest in the collateral. However, this does not accord with section 46(5), which provides:

> Registration of a financing statement or financing change statement:
> (a) does not constitute constructive notice or knowledge to or by third parties of the existence of the financing statement or financing change statement or of the contents thereof; and,
> (b) does not create a presumption that this Act applies to the transaction to which the registration relates

Therefore, filing a financing statement has nothing to do with notice, it simply has the effect of perfecting.

What is the term of registration? Section 51(1) provides that the secured party can construct the term. The cost of registration is directly related to the length of the term. Note, a financing statement is only good for the duration of the term indicated when the financing statement was originally registered. For consumer goods, the maximum term is five years – but the registration may be renewed after five years.

Went over Form 1C at page 272 of the supplemental material. Important points:

1. Line 02 – Ensure that the name that you're including is correct – verify with official government documents and if you can make yourself a copy of said document;
2. Line 10 – Identify the collateral and make sure it is accurate! It is alright to check off all the boxes, but it is not good practice; and,
3. Line 13 – You do not have to fill out a description. Two effects:
    a. You might limit yourself to the description (negative); or,
    b. You might correct some other problem (positive).

The fundamentals of the financing statement are to identify the debtor and to identify the collateral. The identification of the debtor includes the first name, middle initial, surname and date of birth. A lawyer need only meet the standard of a reasonable practitioner in the area in which the lawyer is practicing.

Financing Change Statement

Section 49 provides that you can register a financing change statement any time during the time period of the financing statement. However, if the registration period of the financing statement has expired, there is no point in filing a financing change statement because there is nothing to change. The security must be re-perfected before a financing change statement can be filed. The purpose is to correct errors and amend the financing statement.

Section 47(1) provides:

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A financing change statement may be registered where a security interest is perfected by registration and the secured party has assigned the secured party's interest in all or part of the collateral

Section 48 provides:

(1) Where a security interest is perfected by registration and the debtor, with the prior consent of the secured party, transfers the debtor's interest in all or part of the collateral, the security interest in the collateral transferred becomes unperfected fifteen days after the transfer is made unless the secured party registers a financing change statement

(2) Where a security interest is perfected by registration and the debtor, without the prior consent of the secured party, transfers the debtor's interest in all or part of the collateral, the security interest in the collateral transferred becomes unperfected thirty days after the later of:

a. The transfer, if the secured party had prior knowledge of the transfer and if the secured party had, at the time of the transfer, the information required to register a financing change statement; and,
b. The day the secured party learns the information required to register a financing change statement,

Unless the secured party registers a financing change statement or takes possession of the collateral within such thirty days

Adelaide Capital Corp. v. Integrated Transportation Finance (1994) ON Gen Div

Facts	Holding	Ratio
o Trailers supplied to a debtor who was going to lease them out to other people were classified as equipment in a financing statement o The secured party had gone on to indicate the type of collateral in the general description in some of the financing statements o The secured party 'checked' off all the boxes in some other financing statements and in the description indicated '50 Rousey trailers' o Issue: Is classifying the collateral incorrectly fatal to the registration?	o If you fill out the general description it can help you, or inversely, it can hurt you o Where the collateral is incorrectly classified, a description of the collateral might serve to save the registration o Where the collateral is described in a description, the registration is limited to that which is described	o Where the collateral is described in a description, the registration is limited to that which is described

Searches

There are four general ways that an individual can search the registry:

1. Individual specific – this is the most focused and might not produce as many hits;
2. Individual non-specific – this utilizes just a first and last name and nothing else;
3. Business debtor – get the business name right if you are to use this one;
4. VIN

It is possible to have a registration and, therefore, a perfection of the security interest that is unsearchable.

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Bank of Nova Scotia v. Clinton's Flowers (1994) ON CA

Facts	Holding	Ratio
o Instead of recording the name of the debtor correctly as set forth in the financing statement, the name 'Clinton Flowers & Gifts' was recorded in the registry o Respondent contends that the financing statement was not properly registered and therefore unperfected – it should have priority over the unperfected	o Issue: Did the bank register its security interest before the bankruptcy? o The error was made by a member of the registrar's personnel and as regrettable as the error was, it cannot affect the validity of the appellant's properly registered security interest	o An error made by the registrar's personnel cannot affect the validity of a properly registered financing statement o An error made by the registrar in recording a properly registered document cannot invalidate the registration

The most common unsearchability is the time between the moment of registration and the moment of system re-organization where the financing statement is not found. There is a moment of vulnerability from the point of registration.

Consider section 46(4):

> A financing statement or financing change statement is not invalidated nor is its effect impaired by reason only of an error or omission therein or in its execution or registration unless a reasonable person is likely to be misled materially by the error or omission

Re Lambert (1994) ON CA

Facts	Holding
o GMAC registered a security interest in a vehicle by filing a financing statement o The statement referred to Gilles J. Lambert as the debtor, when Mr. Lambert's proper name is Joseph Phillipe Gilles Lambert o The statement correctly identified Lambert's dob and the vehicles VIN o GMAC filed a proof of claim contending a security interest o Trustee's solicitor made registry inquiries using the name and found no entries – later moved for an order declaring that GMAC's security interest was not perfected o GMAC claims that its errors could be cured by s.46(4) of the PPSA o Issue: When will an error in the contents of a financing statement render the statement invalid and the security interest it represents unperfected as against third parties?	o The provisions provide that the financing statement must be in the prescribed form as set out in O. Reg 912 o GMAC's statement was not in the prescribed form o Does 46(4) alter this result? o An error affects the validity of the financing statement only when "a reasonable person is likely to be misled materially by the error" o Section 46(4) sets out an objective test – it should be interpreted so as to assign the burden of the error system in a manner which best promotes the overall integrity of the system o The reasonable person in s.46(4) has the following attributes: 1. He or she is a reasonably prudent prospective purchaser or lender who looks to the registration system of the PPSA to provide notice of any prior registered claims against the property he or she is proposing to buy or take as collateral for a loan; 2. He or she is conversant with the search facilities provided by the registration system and is a reasonably competent user of those facilities; 3. Where the property to be bought or taken as collateral is a motor vehicle, the reasonable person will obtain the name and birth date of the seller/borrower as well as the VIN of the motor vehicle; and, 4. Where the property is a motor vehicle, the reasonable person will conduct both a specific debtor search and a VIN search o A reasonable person would not likely be misled by an error relating to the debtor's name if that same financing statement accurately set out the VIN o Where the VIN is incorrectly recorded the error would be fatal o Ratio: A creditor's secured interest should not fail as against third parties by virtue of an error in the financing statement, if that error would not

	preclude retrieval of the financing statement by a prospective purchaser or lender taking reasonable steps to protect his or her interest and making reasonable use of the search facilities provided by the registration system

Stewart has some difficulty with this case – the judge provides a metaphor:

> "I proceed on the premise that the prospective purchaser or lender would have access to both the seller/borrower's name and the VIN, and would conduct both searches. An error in a financing statement would probably be materially misleading only if the error caused the financing statement to escape the net case by the combined reach of both searches"

An individual non-specific search along with a VIN search might still materially mislead or be far too cumbersome on the searcher.

Consequences of Unperfection

What if at the relevant time the individual is unperfected, what are the consequences? As between the secured party and the debtor there is nothing wrong with it – it is still a binding contract. Unperfection makes the security only vulnerable to third parties; this is where the weakness lies. There are a number of vulnerabilities to an unperfected security agreement. Consider section 20:

(1) Except as provided in subsection (3), until perfected, a security interest,

(a) In collateral is subordinate to the interest of:

i. A person who has a perfected security interest in the same collateral or who has a lien given under any other Act or by a rule of law or who has a priority under any other Act, or
ii. A person who assumes control of the collateral through execution, attachment, garnishment, charging order, equitable execution or other legal process; or
iii. All persons entitled by the Creditor's Relief Act or otherwise to participate in the distribution of the property over which a person described in subclause (ii) has assumed control, or the proceeds of such property;

(b) In collateral is not effective against a person who represents the creditors of the debtor, including an assignee for the benefit of creditors and a trustee in bankruptcy;

(c) In chattel paper, documents of title, securities, instruments or goods is not effective against a transferee thereof who takes under a transfer that does not secure payment or performance of an obligation and who gives value and receives delivery thereof without knowledge of the security interest;

(d) In intangibles other than accounts is not effective against a transferee thereof who takes under a transfer that does not secure payment or performance of an obligation and who gives value without knowledge of the security interest

Note: subparagraph (c) deals with a transferee and not a purchaser – what is the significance? It cannot be a transferee who secures payment or performance of an obligation. Such a transferee is another secured party. Suppose that a secured party has an unperfected security interest with a debtor. Consider if the debtor transfers the collateral to a transferee. In this situation, the transferee will take free and clear of original secured party. However, this transferee cannot be another secured party – the debtor cannot create another security interest over the same collateral.

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There are four requirements for (c) to apply:

1. There must be a transfer, but not one that gives a security interest;
2. The giving of value;
3. The transferee receives delivery; and,
4. Good faith without knowledge

Dawson Case

Facts	Holding
o The debtor had given a security interest to the bank o The two had agreed to enter into a contract on the 15th for a car o The bank filed a financing statement on August 16 at 8:47am o The day before, the debtor had attended a used car lot and purported to sell the collateral to Dawson motors o Dawson conducted a PPSA search on August 16th at 1pm and found no hits – Dawson paid for the collateral satisfied that there was no security interest	o The court found against Dawson o Value in 20(1)(c) means actual reliance value, not simply a promise to give the money o Note: This decision was made based on a previous incarnation of the legislation

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Important Considerations

Basic Priority Rules

Section 21(1) provides continuity of perfection rules:

> If a security interest is originally perfected in any way permitted under this Act and is against perfected in some way under this Act without an intermediate period when it was unperfected, the security interest shall be deemed to be perfected continuously for the purposes of this Act

Section 30(2) provides:

> For the purposes of subsection 1 the continuously perfected security interest shall be treated at all times as if perfect by registration, if it was originally so perfected, and it shall be treated at all times as if perfected otherwise than by registration if it was originally perfected otherwise than by registration

Section 30(6) provides:

> Where a security interest that is perfected by registration becomes unperfected and is again perfected by registration, the security interest shall be deemed to have been continuously perfected from the time of first perfection except that if a person acquired rights in all or part of the collateral during the period when the security interest was unperfected, the registration shall not be effective as against the person who acquired the rights during such period

Section 24(1) provides:

> A security interest in instruments, securities or negotiable documents of title is perfected security interest for the first tend days after it attaches to the extent that it arises for new value secured by a written security agreement

Section 30(1) provides:

> If no other provision of this Act is applicable, the following priority rules apply to security interests in the same collateral: (1), (2), (3), and (4).

1. Where priority is to be determined between security interests perfected by registration, priority shall be determined by the order of registration regardless of the order of perfection
2. Where priority is to be determined between security interests perfected by registration and a security interest perfected otherwise than by registration
    a. The security interest perfected by registration has priority over the other security interest if the registration occurred before the perfection of the other security interest, and
    b. The security interest perfected otherwise than by registration has priority over the other security interest, if the security interest perfected otherwise than by registration was perfected before the registration of a financing statement related to the other security interest
3. Where priority is to be determined between security interests perfected otherwise than by registration, priority shall be determined by the order of perfection; and,
4. Where priority is to be determined between unperfected security interests, priority shall be determined by the order of attachment.

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Hypothetical – Duke and Finco

Finco has the security interest because he was the first to register. Support for this proposition is found at section 30(1)1 of the *OPPSA*. In the case of consumer goods, if you file a financing statement until the security agreement is signed, then you will not be given priority. You cannot file a financing statement before a security agreement in the case of consumer goods.

Hypothetical – Sally and Fred

A perfected security interest that is perfected at the date of bankruptcy beats the trustee in bankruptcy. Did the registration occur before the perfection of Finco? Yes. Section 30(1)(2)(i) provides that, "the security interest perfected by registration has priority over the other security interest if the registration occurred before the perfection of the other security interest". Finco attached first, Finco perfected first – Why should Sally win? The rationale behind it is that by filing the registration Sally is saying to Finco, "you should not have taken a security interest before you investigated my interest in it". The filing of the financing statement is not notice to the world, but a reasonable person who conducts a PPSA search should become aware of it.

Notice that there are significant differences when we ask: who was the first to attach, who was the first to perfect, who was the first to file.

Zap! You're Frozen

Two secured parties at some point when fighting over the same collateral are said to come into conflict. The courts have said that when you come into conflict, you are frozen – you cannot do anything more to better your position. There are a number of cases relating to section 30 that must consider when the conflict occurs. Where one secured party takes a move to *enforce* the security that is when the conflict is going to arise. Conceptually, this is where the two property interests are going to collide. One of the secured parties is going to be wrong and, conceptually, the wrong party has committed conversion.

A secured party who is in conflict with a trustee in bankruptcy, that secured party cannot do anything to better his position after bankruptcy vis-à-vis the trustee in bankruptcy. A bankruptcy freezes the secured party. However, it is not clear whether or not bankruptcy freezes a secured party vis-à-vis another secured party. While clear in the United States, this point is not clear in Canada.

Future Advances

The future advance, if the security agreement says so, has the same priority as the first advance. Section 13 provides:

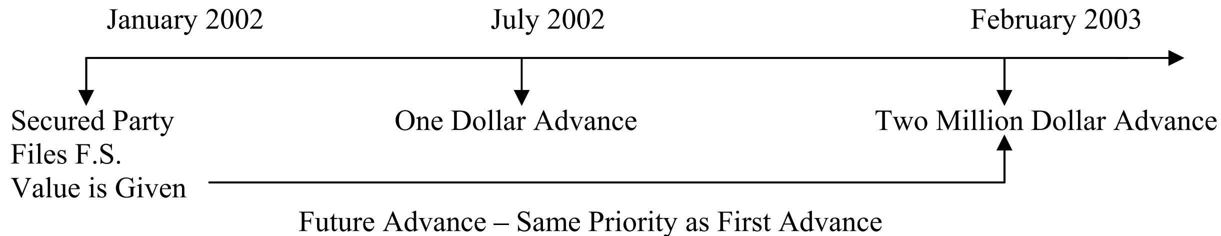
> "A security agreement may secure future advances"

Section 13 does not concern itself with the priority conflicts that arise where there are competing security interests and one of the secured parties makes more than one advance.

Section 30(3) provides:

> "Subject to subsection (4), where future advances are made while a security interest is perfected, the security interest has the same priority with respect to each future advance as it has with respect to the first advance"

When does the first advance take place? The word is not defined in the Act. As soon as one dollar is advanced to the debtor, then the secured creditor has a security interest in the one dollar. If two million dollars are later advanced, then the secured creditor has a security interest in the two million dollars – this is a future advance. The future advance will have the same priority as the first advance.



There is some very limited protection from the future advance clause working in favor of a seizing sheriff. Section 30(4) provides:

> A future advance under a perfected security interest is subordinate to the rights of persons mentioned in subclauses 20(1)(a)(ii) and (iii) if the advance was made after the secured party received written notification of the interest of any such person unless,
> (a) the secured party makes the advances for the purposes of paying reasonable expenses, including the cost of insurance and payment of taxes or other charges incurred in obtaining and maintaining possession of the collateral and its preservations; or
> (b) the secured party is bound to make the advance, whether or not a subsequent event of default or other event not within the secured party's control has relieved or may relieve the secured party from the obligation

Any advance after a bankruptcy must go to the trustee in bankruptcy because s/he is now the debtor. No secured party is ever going to advance money to the original debtor.

Future Transactions

If there is a financing statement that exists that may serve as a blinking yellow light, it may also serve to perfect future transactions. Section 45(4) provides:

> Except where the collateral is consumer goods, one financing statement may perfect one or more security interest created or provided for in one or more security agreements between the parties, whether or not,
> (a) the security interest or security agreements are part of the same transaction or related transactions; or
> (b) the security agreements are signed by the debtor before the financing statement is registered

In what situation are you going to find future advance clauses and after-acquired property clauses and where are you going to find future transactions. Consider, if one is Sony Corporation and another is a dealer in Sony products and Sony is going to supply the reseller on an ongoing basis, Sony is going to maintain a security interest in the goods supplied. How should this security agreement be structured? An easy way to do it is to take a security agreement that grants an interest in receivables, inventory, after-acquired property etc., In other words, once title passes Sony Corp. retains a security interest secured by a priority date of filing. We have a future advance clause and an after-acquired property clause. Typically, however, Sony would not want to do it that way for business reasons.

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Sony is not going to enter into one overall transaction with the reseller. Sony might, every time a new shipment is sent, require the reseller to sign a new security agreement – in essence, a conditional sales contract. Sony would then take that conditional sales agreement and finance it through Sony financing (Finco). These are a series of transactions – the issue becomes: Does Sony have to file a financing statement every time a new security agreement is signed? The early decision said no: one financing statement describing the debtor and the collateral serves to perfect all the separate transactions. In *Re Adelaide* one of the arguments that was put was that a financing statement that had been filed could serve to perfect all of the transactions. In order for one financing statement to perfect subsequent transactions, there has to be some notional link between the financing statement and the transaction. In other words, the parties must have contemplated ongoing transactions.

This notion was causing trouble in the leasing industry. If an individual leased equipment one year and then leased another one year later, could the financing statement apply to the second lease? Section 45(4)(a) gets over the necessity for some connection or relatedness. We can have a situation whereby A takes a security interest in some equipment from B and files a financing statement. B could pay off the equipment, but the financing statement still is in the system. If A and B enter into another transaction, but the new financing statement is defective. Can A rely on the former financing statement? Yes, the argument will work – the former financing statement will cover future transactions.

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Purchase Money Security Interests and Superpriority (PMSIS)

The PMSI was developed in order to break the situational monopoly of a secured party. Suppose a bank has a security agreement covering a very broad range of assets with an after-acquired property clause and a future transactions clause with a registered filing statement. Consider a debtor who is a large furniture reseller. At the relevant time there is two million dollars owing to the bank. The debtor has asked the secured party to advance another $500,000, but the debtor is denied because of the high-risk exposure. The debtor can go out and borrow money, but if the debtor is going to borrow on a secured basis, the lender's security interest would seem to be subordinate to the bank's interest by virtue of the original security agreement. If the debtor receives something from the second lender, the bank would obtain an interest in the monies lent – this creates a situational monopoly for the bank.

If the debtor goes out and gets another security interest, and if that other security interest is a PMSI and in addition if the debtor does the right things, then the lender will be given priority over any other secured party in the collateral given by the same debtor. Section 33 provides:

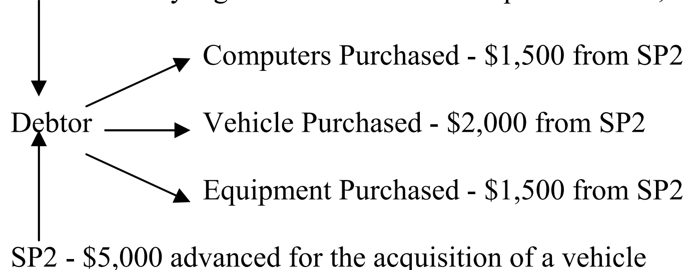
> A purchase money security interest in inventory or its proceeds has priority over any other security interest in the same collateral given by the same debtor, if…

The definitions section of the Act provides:

> "purchase-money security interest" means,
> (a) a security interest taken or reserved in collateral to secure payment of all or part of its price, or
> (b) a security interest taken by a person who gives value for the purpose of enabling the debtor to acquire rights in or to collateral to the extent that the value is applied to acquire the rights,
> but does not include a transaction of sale by and lease back to the seller"

"(a)" is referred to a seller's PMSI, such as a conditional sales contract. It is "(b)" that causes the problem. "(b)" is called a lender's PMSI – it must be value given for the purpose of enabling the debtor. There is a purposive element. In other words, the value given must be for some defined purpose. The secured interest only applies to the extent that the value actually went towards that defined purpose. While the individual may have a security interest in the collateral, the individual may not have a PMSI in the collateral. It is very important to satisfy the PMIS requirements; otherwise the security interest may be subordinate to any other relevant secured party. In order to claim the super priority, the elements of the PMSI must be proven.

SP1 – Security Agreement with After-Acquired Clause, Future Transactions Clause and Filed F.S.



SP2's PMSI extends only insofar as the value given enables the debtor to acquire the vehicle and it is actually used for the purpose – only $2,000 of the monies advanced have super-priority

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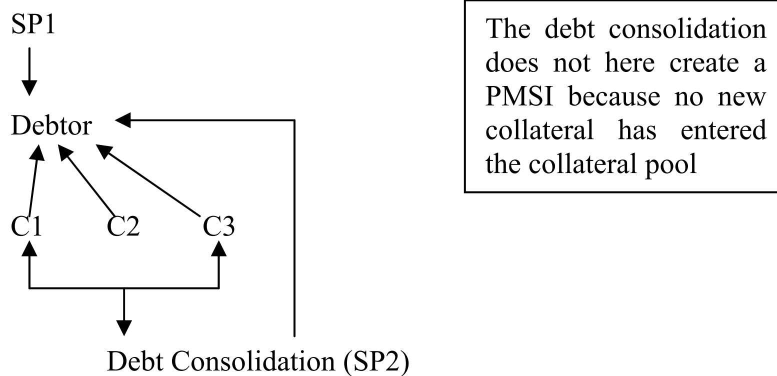
ACCS v. Pettyjohn (1991) Sask CA

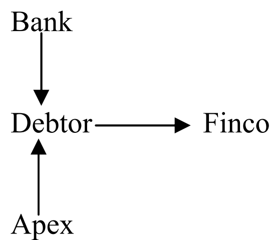
Do this case self

Facts	Holding
○ ACCS was approached because the Pettyjohn's wanted to buy some cattle ○ The Pettyjohn's went out and borrowed the money from the Bank of Montreal – they bought the cattle ○ ACCS advanced the money to the Pettyjohns for the cattle ○ The Pettyjohns went bankrupt	○ Can it be said that the money advanced by ACCS was for the purpose of acquiring rights in the collateral? Was it actually used to acquire rights in the collateral? ○ The 'value' was the commitment to advance money ○ The Court reasons that this is a PMSI

Problem: Does SP2 have a PMSI? No, no new value has entered the collateral pool.



Hypothetical – Finco and Apex p. 19



On the assumption that Finco is second in priority to the bank and Apex advances money to pay off Finco – is there any way that Apex should have a PMSI? When Finco was paid, did the debtor have more rights in the property than s/he had before? If the effect is depleting the collateral pool, the party putting forward the PMSI will lose – the collateral pool cannot be depleted.

What is the purpose of PPSA legislation? When you get a security interest you get a separation of a property interest (title) and possession, which may be misleading to third-parties who want to deal with the property (collateral). We are telling the secured party that s/he had better file a financing statement to give fair warning (from his/her point of view) in order to protect the interest. Against this theory is a regime of rules relating to priority of interest. Secured parties want certainty of outcome and they will take it over fairness.

What is the purpose of the PMSI? There are two reasons:

1. We want to break the situational monopoly that SP1 has through after-acquired property clauses and futures by allowing a new creditor to finance the debtor; and,
2. It would be unfair to allow SP1 to have new value come into the collateral pool and thus gain the windfall over the secured party who has sent it in.

There is a conflict between fairness on the one side and certainty on the other. If fairness is the doctrine that is driving the decision, then the legislation ought to be rewritten.

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In the Matter of the Bankruptcy of N'Amerix Logistix Inc. (2001) ON SC

Facts	Holding	Ratio
○ Bank had a security interest in all of the debtor's assets and it had filed a financing statement ○ The debtor entered into a contract with Factors, who became a secured party ○ The factor did not perfect the security interest by registration ○ The debtor goes bankrupt	○ If you are looking for certainty, the factor should lose ○ The banks financing statement was never discharged ○ The factor, by advancing money to pay off the bank, should be subrogated into the bank's position ○ Bank wins by virtue of subrogation	○ The party putting forward a PMSI cannot deplete the collateral pool to the detriment of SP1 – SP1 cannot be unjustly enriched by additional value added to the collateral pool, yet conversely, s/he cannot suffer as a result of a depletion to the collateral pool

Priority of the Inventory Financier

Section 33(1) of the Act provides:

> A purchase money security interest in inventory or its proceeds has priority over any other security interest in the same collateral given by the debtor, if,
> (a) the purchase-money security interest was perfected at the time,
> i. the debtor obtained possession of the inventory, or
> ii. a third party, at the request of the debtor, obtained or held possession of the inventory, whichever is earlier;
> (b) before the debtor receives possession of the inventory, the purchase-money secured party gives notice in writing to every other secured party who has registered a financing statement in which the collateral is classified as inventory before the date of registration by the purchase-money secured party; and,
> (c) the notice referred to in clause (b) states that the person giving it has or expects to acquire a purchase-money security interest of the debtor, describing such inventory by item or type

In order to get super-priority in the case of an inventory PMSI the secured party must jump through the following hoops:

1. File a financing statement before the debtor gets possession of the goods (this time constraint is inserted because;
2. In addition to being perfected at the date that the debtor gets possession, when you have filed the financing statement do a PPSA search against the debtor and find out if there are any financing statement's filed against the debtor's name that check off the inventory box and provide notice to any party with a security interest in that inventory

North Platte State Bank v. Production Credit Association (1972)

Do this self

Facts	Holding
○ What is the purpose of the time constraint?	○ To hold otherwise, not to pay attention to the time limit, renders the language of the statute meaningless and purports a construction wholly unrelated to setting up an ascertainable time standard by which priorities may be established so that a subsequent lender can achieve priority over the first to file ○ The integrity of the transaction had to be guaranteed by an ascertainable standard related to the receipt of possession, and the retroactive granting of priority over the first to file and the first to advance funds

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Clark Equipment of Canada v. Bank of Montreal (1984) Man. CA

Do this self

Facts	Holding	Ratio
o Clark had taken a security interest in products – they are purporting to take super-priority in products that they did not supply to the debtor	o Does the mixture of a PMSI with other security interests preclude the appellants from claiming a purchase-money security interest in the three pieces of equipment	o There is no magic in the words PMSI or magic in putting them in the financing statement so long as the paper trail exists in support

Re Chrysler Credit Can. Ltd. (1986) Sask CA

Do this self

Facts	Holding
o The bank took the first security interest and filed it first – it was taken in "all goods now or hereafter owned or acquired by the debtor … all equipment …" o Chrysler supplied new vehicles pursuant to secured financing o The collateral fought over are trade-ins on the lot	o *Who has priority over the trade-ins?* o Three types of trade-ins: 1. Trades where the purchase had not been repaid (4); 2. Trades where the loans had been repaid (31); and, 3. Trades that could not be linked (9) to the sale of new cars o Can the trade-ins be identified as one class? o The court looks at the agreements between Chrysler and the debtor o The parties to the agreement intended Chrysler Credit's security interest to attach to the whole of the new and used car inventory (cross over security) – as long as any part of the indebtedness remained owing, the inventory remained liable to satisfy it o *Does Chrysler have a PMSI?* o Each of the trades in the second category secured not only one advance, but all the advances or the whole of the indebtedness from time to time outstanding o The trades must be seen as forming party of a class of property, namely inventory; and it was that class which was used to secure the grant of credit on an ongoing or revolving basis o **Ratio:** A PMSI in inventory can apply to an entire class of inventory so long as the paper trail is there in support

Section 9-103(b) of the UCC provides an amendment to make clear that you can get PMSI super-priority on an entire class of inventory.

Non-Inventory PMSI

Section 33(2) provides:

> Except where the collateral or its proceeds is inventory or its proceeds, a purchase-money security interest in collateral or its proceeds has priority over any other security interest in the same collateral given by the same debtor if the purchase-money security interest,
>
> (a) in the case of collateral, other than an intangible, was perfected before or within ten days after,
>
> i. the debtor obtained possession of the collateral as a debtor, or
>
> ii. a third party, at the request of the debtor, obtained or held possession of the collateral, whichever is earlier, or
>
> (b) in the case of an intangible, was perfected before or within tends days after the attachment of the purchase-money security interest in the intangible

North Platte Bank v. Production Credit Ass'n (1972)

Facts	Holding
○ The PCA had a security interest with the debtor and filed it ○ The debtor, Tucker, purchased cows for $20,000 by cheque from Mann and received them on November ○ The bank, upon which the bank was drawn, did not pay the cheque ○ Tucker tried to arrange the cheque to be cleared ○ In January the bank honored the cheque, but took a security interest in the cows and filed a financing statement	○ Issue: As between the bank and PCA, who wins? ○ There are two issues: (1) did the bank take a PMSI and (2) did they jump through the right hoops? ○ The court asks how one can have a definitional PMSI when title to the cows had passed to Tucker (was there an addition to the collateral pool?) ○ A debtor must have full possession of the collateral at the critical point in time – the time limits are there to give the situation some certainty (a third party viewing the situation must be able to decipher who is in possession etc.,) ○ You are not a debtor until you have signed a security agreement

The Canadian cases have loosened up the idea of the PMSI – whether or not the money was advanced for the purpose of acquiring rights in the collateral and if it was actually used for. The courts looked for some real and substantial connection. The second element is the time limitation – the courts have been loosening up here also. The American position, on the other hand, is strict.

"As a debtor" – these words were added in 1987 and were seen as adopted the *Brodie* case (possession as a leasee is not possession that starts the ten days ticking). However, it was always thought that possession where the purchase price is held, but this is being eroded by the *Mack* case.

Mack v. Essential Concrete (2002) ON SCJ

Facts	Holding
○ A Mack truck was had for one month and it was argued that possession was had	○ The date that initiates the 10-day period for perfecting a PMSI is the date the debtor becomes a debtor under the security agreement – in other words, the debtor must actually have rights in the collateral

PMSI and Section 20

Subsection 20(3) provides:

> A purchase money security interest that is perfected by registration
> (a) in collateral, other than an intangible, before or within ten days after,
>   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 earlier; or
> (b) in an intangible before or within ten days after the attachment of the security interest in the intangible, has priority over,
> (c) an interest set out it subclause (1)(a)(ii) and is effective against a person described in clause (1)(b); and,
> (d) the interest of a transferee of collateral that forms all or part of a sale in bulk within the meaning of the Bulk Sales Act

This section was inserted for the benefit of mid-level retailers. It provides the retailer with a 10-day buffer to register a security interest in the item.

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Hypothetical – Jack and Acme

Subsection 20(3) does not protect Jack from another secured party. In order to get protection from the bank, Jack would have had to file the financing statement on the date that the debtor Acme had possession of the collateral. Subsection 20(3) does provide for a ten day period, but not for inventory PMSI against other secured parties.

Subordination Agreements

Section 38 of the Act provides:

> A secured party may, in the security agreement or otherwise, subordinate the secured party's security interest to any other security interest and such subordination is effective according to its terms.

It is quite common to have secured parties subordinating themselves to others. The most common is where you have an inventory financer and a receivables financer. The idea is that the I.F. will have a security interest in the entire inventory and all the proceeds – proceeds are receivables. The R.F. is going to take a security interest in the accounts. It appears that the I.F. and R.F. are going to come into conflict over the accounts. Who has priority in what? It is not uncommon for the I.F. to subordinate him or herself to the R.F. for all or some of the receivables.

Suppose you have a subordination agreement between two secured parties – it becomes problematic where you have in the security agreement between the debtor and the secured party a provision that says, "we agree to subordinate ourselves to X; we agree to subordinate to a PMSI". Suppose a PMSI party has not jumped through the right hoops. How can a PMSI party take advantage of this contract? The PMSI supplier can win unless the debtor can prove that the intention of the party was to say, "We agree to subordinate to a PMSI *if they jump through the right hoops*".

Where this interpretation is difficult is in the floating charge. Suppose an individual argues that s/he has a floating charge over everything and that the secured party gives permission to the debtor to carry on business. This is an attached fixed charge. It can be argued that in so doing the secured party is agreeing to subordinate himself so long as the transactions occur in the 'ordinary course of business'. The question turns to, "What is the ordinary course of business?" Ordinary course of business includes paying off secured creditors and debts. The big issue has been whether the debtor pays his or her taxes. Note: Section 38 provides "or otherwise" – this allows the doctrine of estoppel to enter the fray.

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Transfer of Collateral

Statutory Framework

Suppose you have a secured party and a debtor. The security agreement indicates that the debtor does not agree to transfer the collateral in anyway without the consent of the secured party. What if the debtor, in violation of that clause, purports to give another security interest or transfer in some way a property right in that collateral? What about the transferee? Is a contractual promise by the debtor to the secured party sufficient enough to take away power?

Section 39 of the Act provides:

> The rights of a debtor in collateral may be transferred voluntarily or involuntarily despite a provision in the security agreement prohibiting transfer or declaring a transfer to be a default, but no transfer prejudices the rights of the secured party under the security agreement or otherwise

Take note of "but no transfer prejudices the rights of the secured party under the security agreement or otherwise". We will see lots of cases where if the debtor transfers the party with or without permission that the secured party *will* be prejudiced. It should say, "the transfer will not prejudice the secured party *except* as set out in this Act or any other Act".

Section 25 of the Act provides:

> (1) Where collateral gives rise to proceeds, the security interest therein,
> (a) continues as to the collateral, unless the secured party expressly or impliedly authorized the dealing with the collateral free of the security interest; and
> (b) extends to the proceeds

Subsection 25(1)(a) is simply a reflection of the *nemo dat* rule. However, there may be some exceptions to the *nemo dat* rule.

Consider section 28(1):

> A buyer of goods from a seller who sells the goods in the ordinary course of business takes them free from any security interest therein given by the seller even though it is perfected and the buyer knows of it, unless the buyer also knew that the sale constituted a breach of the security agreement

What do we mean by 'ordinary course of business'?

Camco Inc. v. Olson Realty (1979) Sask CA

Facts	Holding
o People were buying condos o The developer in order to sell was being quite nice to the purchasers o The developer agreed to pay all the legal fees of the sale o Two months after closing a secured party comes along and declares that all the appliances,	o Issue: Was this a sale in the ordinary course of business – is the developer in the business of selling a fridge, washer, stove, etc.,? o The Sask. Section really means whether it is the ordinary course of business of this seller o In Ontario, it is the ordinary course of business of that type of seller

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which were bought on credit from the developer, are going to be repossessed	

Fairlane Boats v. Leger et al. (1980) ON SCJ

Facts	Holding	Ratio
o A boat was bought at a highway rest stop at about 60% of asking price at a boat show o Delivery was taken immediately o The dealer sold the boat because he was going under and he wanted to offload the assets o Bank asks where the boat is	o Was the boat sold in the ordinary course of business? o It is not uncommon for a boat to transfer between dealers o Boats are generally sold any place o It was not common to sell the boat at such a discount	o The court will look at the transaction and consider whether the steps undertaken are normal steps in the ordinary course of business among people in the business generally

Hypothetical – Tilley and Westshore Marines

Westshore sells a used boat to Tilley on July 1, 1993. On July 1, 1994 Tilley discovers via letter that Finco has a security interest in the boat. Tilley should argue that under section 28(1) it took free and clear of any other security interest. Westshore did not create a security interest with the bank. If the bank becomes unperfected, is that going to help Tilley? Tilley cannot find shelter in section 20 of the Act because while he took for value etc., it was a perfected security interest. You might opine that Tilley might be protected – however, the problem is that the Act states otherwise. Tilley has to find protection.

If a secured party finds that the debtor has transferred the collateral to someone else with or without permission, should we put an onus on the secured party to file a financing change statement to identify the new debtor? Would that new buyer owe value to SP? No – they never contracted to pay (no privity). However, is the boat still subject to the security interest? There should be some onus on the bank to file a financing change statement in order to maintain the integrity of the system.

Note sections 48(1) and 48(3) – 48(1) assuming that there is the prior consent of the SP, you might say that there has to be a conflict between the section and section 25 – the secured interest continues in the collateral.

Section 48 provides:

(1) Where a security interest is perfected by registration and the debtor, with the prior consent of the secured party, transfers the debtor's interest in all or part of the collateral, the security interest in the collateral transferred becomes unperfected fifteen days after the transfer is made unless the secured party registers a financing change statement within such fifteen days

(2) Where a security interest is perfected by registration and the debtor, without the prior consent of the secured party, transfers the debtor's interest in all or part of the collateral, the security interest in the collateral transferred becomes unperfected thirty days after the later of,

   a. The transfer, if the secured party had prior knowledge of the transfer and if the secured party had, at the time of the transfer, the information required to register a financing change statement; and
   b. The day the secured party learns the information required to register a financing change statement; and

Unless the secured party registers a financing change statement or takes possession of the collateral within such thirty days.

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Spittlehouse v. Northshore Marine Inc. (1994) ON CA

Facts	Holding
○ Spittlehouse was buying a $550,000 sailing yacht from Northshore – it had to be built ○ Northshore, in the agreement, included a term – "title remains in Northshore until purchase price is fully paid" ○ The bank, Transamerica, has a security interest in Northshore's inventory ○ The boat was built and was ready for delivery – Spittlehouse had paid the full amount except $10,000 ○ Northshore defaults on the loan from Transamerica – pursuant to the security interest a receiver is sent it and controls inventory	○ Issue: Is the boat still subject to the security interest or is it taken off by the sale to Spittlehouse? ○ Section 28(1) is not here applicable because title had not yet passed to Spittlehouse ○ 'Title remains in the seller' – this does not necessarily mean that title does not pass – you have a defective title ○ In order for title to pass you have to: (1) have the goods ascertained, and (2) the seller must have some title to pass

Why did the 'ordinary course of business' argument not apply? The problem is that a seller who 'sells' has sold something. In order to characterize a sale, you have to ensure that title has passed to Spittlehouse. Since title had not passed to Spittlehouse, section 28(1) does not apply.

Royal Bank of Canada v. 216200 Alberta Ltd. (1987) Sask CA

Facts	Holding
○ People were pre-paying for furniture ○ There were a number of classes: (1) those who have paid, but the goods are not identified, (2) those who have paid for identified goods, (3) those who have paid part of the price for unidentified goods, and (4) those who are owed cash refunds	○ (1) Title cannot pass because the goods are not identified ○ (2) Title can pass because the goods are identified and paid for ○ (3) Title cannot pass because of (1) and less consideration ○ (4) Money cannot be identified – the only way to get it back is to create a trust ○ The two indicia for sale in the ordinary course of business have been met: those persons who paid part of the purchase price for goods in the possession of the vendor which were in a deliverable state, and identified in some fashion as being the goods purchased, have priority over the security interests of the appellant.

Tanbro Fabrics Corp. v. Deering Milliken Inc. (1976) NY CA

Do This Self

Facts	Holding
○ Tanbro is a seller of greige goods to Mill fabrics ○ Although there had been a sale, Tanbro still had possession and they were awaiting the call for delivery ○ Tanbro retained a security interest in all products sold to Mill – secured all monies always from Mill fabrics ○ Mill sold the greige to Deering ○ Mill does not pay Tanbro ○ Deering argues 28(1) to take free and clear as a purchaser in the ordinary course of business	○ A secured party who is secured by having possession of the collateral is still vulnerable to section 28(1)

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Transfers of Instruments and Negotiable Documents of Title

Section 26 of the Act provides:

> A security interest in goods in the possession of a bailee who has issued a negotiable document of title covering them is perfected by perfecting a security interest in the document, and any security interest in them otherwise perfected while they are so covered is subject thereto

Where goods have been bailed and a negotiable document of title has been issued towards them, if you are going to take a security interest, you do not take them in the goods, but instead in the document of title.

Document of title is defined in the Act as:

> "any writing that purports to be issued by or addressed to a bailee and purports to cover such goods in the bailee's possession as are identified or fungible portions of an identified mass, and that in the ordinary course of business is treated as establishing that the person is possession of it is entitled to receive, hold and dispose of the document and the goods it covers".

A non-negotiable receipt is defined in the *Warehouse Receipts Act* as follows:

> Means a receipt in which it is stated that the goods therein specified will be delivered to the holder thereof

If the document of title says it is a warehouse receipt to X, it is not negotiable because it identifies a specific individual. However, if the receipt says deliver to X or order, it is negotiable. How does an individual perfect a security interest in a document of title? One way is to take possession of the document of title – the other way is to file a financing statement. In filing the financing statement, how would the goods be identified? A document of title should be classified as 'other'.

Section 28(4) provides:

> A purchaser of collateral that is an instrument or negotiable document of title has priority over any security interest therein perfected by registration or temporarily perfected under section 24 if the purchaser,
> (a) Gave value for the interest purchased;
> (b) Purchased the collateral without knowledge that it was subject to a security interest; and,
> (c) Has taken possession of the collateral.

A security interest taken in an instrument or a negotiable document of title and is perfected by registration is very vulnerable. A party who is taking a security interest in an instrument or negotiable document of title ought to take possession of those instruments or documents of title. This is another exception to the *nemo dat* rule – unless you get possession of that document one is always vulnerable.

The Nature and Transfer of Chattel Paper

Chattel paper is defined in the Act:

> "Chattel paper" means one or more than one writing that evidences both a monetary obligation and a security interest in or a lease of specific goods

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Chattel paper is a security interest taken in specific goods – specific goods are goods identified and agreed upon at the time the contract is made. The classic form of chattel paper is a conditional sale contract.

Hypothetical – Judy and Downtown Motors

Is Finco covered by the rules of the PPSA? Yes, because under section 2 a transfer of chattel paper or accounts is swept into the Act. If Downtown Motors becomes bankrupt, what are the priorities in the chattel paper – who has the right to the stream of payments from Judy? Finco has priority because they have possession. If Finco had decided to leave the chattel paper in Downtown's possession, and decided to perfect by filing a financing statement – the collateral would have to be described as 'other'.

If you collateral is chattel paper you better get possession of it otherwise you are vulnerable.

Section 28(3) provides:

> "A purchaser of chattel paper who takes possession of it in the ordinary course of business and gives new value has priority over any security interest in it,
> (a) That was perfected by registration if the purchaser did not know at the time of taking possession that the chattel paper was subject to a security interest; or
> (b) That has attached to proceeds of inventory under section 25, whatever the extent of the purchaser's knowledge"

Ordinary course of business in this context means ordinary course of business of the buyer. Chattel paper has been made somewhat negotiable – but not as negotiable as a document of title. A lease of goods is also chattel paper.

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Proceeds

Section 28(5) provides:

> Where a motor vehicle, as defined in the regulations, is sold other than in the ordinary course of business of the seller and the motor vehicle is classified as equipment of the seller, the buyer takes it free from any security interest therein given by the seller even though it is perfected by registration unless the vehicle identification number of the motor vehicle is set out in the designated place on a registered financing statement or financing change statement or unless the buyer knew that the sale constituted a breach of the security agreement.

Section 29 provides:

> The rights of a person who is,
> (a) a holder in due course of a bill, note or cheque within the meaning of the Bills of Exchange Act; or
> (b) a transfer from the debtor of money
> are to be determined without regard to this Act.

These are excluded because federal Acts cover those instruments. Anything the federal government does would trump this provincial legislation in any event. Subsection 28(4) and 29 appear to duplicate each other. Under subsection 29(a) money may be held as collateral – does the security interest attach to the collateral. Even stolen money, when transferred to a good faith person under the common law, can be taken free and clear. One of the issues that sometimes come up is what is meant by 'money'. Can 'money' be expanded – what about the transfer of a term deposit?

The Right to Follow Proceeds

Flintoft v. Royal Bank of Canada (1964) SCC

Facts	Holding	Ratio
o A bank had a security, but it was a security under the Bank Act in inventory o The bank also took an assignment of book debts (pre-PPSA) – this is to be registered, here it was not o The trustee in bankruptcy argues the assignment of book debts had not been filed and, thus, cannot take priority – also, the security was not inventory	o There is a common law right to proceeds o The court concludes that the parties must have agreed to the secured creditor's right to follow the proceeds of inventory	o The secured party has the right to follow the proceeds in inventory

The PPSA addresses this issue at section 25(1)(b):

> (1) Where collateral gives rise to proceeds, the security interest therein,
> (b) extends to the proceeds

Whether there is a contractual clause or not, the security interest will extend to the proceeds by statute. The other provisions, however, should be noted. Consider subsection 25(2):

> "Where the security interest was perfected by registration when the proceeds arose, the security interest in the proceeds remains continuously perfected so long as the registration

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> remains effective or, where the security interest is perfected with respect to the proceeds by any other method permitted under this Act, for so long as the conditions of such perfection are satisfied"

The term 'proceeds' is defined by the Act:

> "proceeds" means identifiable or traceable personal property in any form derived directly or indirectly from any dealing with collateral or the proceeds therefrom, and includes any payment representing indemnity or compensation for loss of or damage to the collateral or proceeds therefrom

What does 'dealing' in this definition mean? Note: those objects produced by the machine are not personal property derived from any dealing with it. Rather, "proceeds" is meant to cover any dealing relating to the property rights in the machine. Is the definition of proceeds under the Ontario Act broad enough to extend to dividends that are paid on a share? What about interest on an account?

Second-Generation Proceeds

The next issue that comes up is the problem of second-generation proceeds. Consider where a secured party has a security interest in a vehicle and the debtor wrongfully sells the car to another individual (D). Anything the debtor gets from D is proceeds from the sale of the car and should return to the secured party. However, if D sells to another purchaser (T) and gets back from T a trade-in, is that trade-in proceeds such that it would fall under the original security interest? How can SP have a security interest in personal property in which the debtor has no interest? The Ontario Act is broad enough to sweep the trade-in into the definition of proceeds (Stewart knows of no cases). The concept of proceeds requires a 'dealing in' the collateral in order for the secured party to have an interest in the proceeds.

Tracing Proceeds

To what extent do you have to be able to trace the proceeds? This concept often comes up between a trustee in bankruptcy and a third-party. We might also see it between two secured parties where one is claiming a registered security interest and the other a PMSI in the collateral (usually a vehicle). The third type of case is where you get a secured party up against the bank and the bank is claiming rights as a bank – the right to set-off debts against the bank accounts.

In the definition of proceeds the Act uses the terms 'identifiable' and 'traceable'. The terms 'identifiable' and 'traceable' are not defined in the Act.

Tracing at Law

Banque Belge v. Hambrouk (1921) Eng CA

Facts	Holding
○ A promissory note had been given in return for illegal consideration ○ The note had been discounted to a bank and made into a deposit – it was the only money in the account	○ Issue: Could the claimant trace the promissory note into the bank account at law (legal title)? ○ The court answered in the affirmative

If you are using legal tracing, a bona fide purchaser for value without notice is no defense against the secured party, unless you can find some statute that says that it is a defense. Tracing at law is wide, but the problem is that you cannot trace into a mixed bank account.

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Tracing in Equity

Equity stops short of a bona fide purchaser for value without notice. If you are tracing at equity and the proceeds come into the hands of a good faith purchaser without notice, you will lose. Also, you have to find a fiduciary duty in order to apply the equitable title. In other words, you must show that the other individual was either a fiduciary or trustee for you. This is a big problem – courts could stretch it and find resulting trusts and constructive trusts (it has to be brought up in some way). The Canadian courts have now moved to say that in order to trace in equity there is no need to find a fiduciary relationship. This can be accomplished through the instrument of a remedial constructive trust (it is fair and just to do it). The good thing about tracing in equity is that you could trace into a mixed bank account – the problem then became, however, how is the amount split up (it is not likely that the amount found in the account can be split up to satisfy each debt). There are three general rules and an alternative approach:

1. *Rule in Clayton's Case* – monies will be deemed to have been withdrawn in the order in which they were paid into the account: first in, first out (FIFO);
2. *Rule if Hallet's Case* – the wrongdoer will be deemed first to have withdrawn his own money before encroaching on the trust funds: presumption of rightful withdrawal;
3. *Lowest Intermediate Balance Rule (LIBR)* – as money is taken out the individual's claim can only be to the lowest amount of money that was in the account between the time it was put in and the claim time: you cannot take advantage of the new money coming in (lowest balance during the period of time you money was in the account). This is said to be very inconvenient (ON CA has rejected this approach).
4. *Tracing by Subrogation* – one will be allowed to subrogate into the position of another who has priority so that s/he will have priority (you must show that the particular money went to pay for a particular thing).

GM Acceptance Corp. v. Bank of Nova Scotia (1986) ON CA

Facts	Holding
o A secured party (GMAC) had a security interest in the dealer's inventory o The dealer sold some inventory and deposited a cheque in the bank (it becomes a chose in action owing by the bank in the dealer) o The bank exercises a set-off right when the dealer goes bankrupt	o This is a mixed bank account and cannot be traced into because the security agreement with GMAC did not have a trust agreement built into it – no fiduciary relationship and cannot trace in equity o GMAC did not take a security interest in proceeds (section 25 says that it extends by statute) o You cannot trace into a mixed bank account unless there is a trust or fiduciary relationship

This is *dreadful* reasoning – just make sure you put a trust clause in the security agreement, though. You do not need a trust relationship to get into a mixed bank account.

ACC Saskatchewan v. Pettyjohn (1991) Sask CA

Facts	Holding	Ratio
o ACC had a security interest in the 1981 herd of cows o The 1981 herd was paid for and the money was put into a mixed bank account o Money was taken from that	o Issue: Can the PMSI be traced to say that ACC has an interest in the Watusi cattle? o It does not depend on the strict rules of tracing, but instead ask whether there is a "close and	o If the proceeds are substituted collateral, they are traceable if the new collateral has a close and substantial connection to the old collateral

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account to buy the 1984 herd of cows o The 1984 herd was sold and a herd of Watusi cattle was purchased	substantial connection" o	

LSUC v. Toronto Dominion Bank (1998) ON CA

Facts	Holding
o Mr. Upshaw was a dishonest lawyer – he had taken $900,000 from a mixed trust account o The day before the LSUC shut the lawyer down, TD bank had paid in $173,000 to the account, which was to be dispersed to a mortgagor o LSUC freezes the account and bankruptcy ensues	o Issue: TD can trace into the account, but how much do they get? o This is a contest between equally innocent victims – which tracing methodology applies? o Court rejected FIFO and LIBR o The court applies pari passu ex post factu – take the total contributions of all those with claims against the fund at the time of distribution, and multiplying that factor against the total assets available for distribution, in order to determine the claimant's pro rata share of those remaining funds o If nobody has super-priority, apply pari passu ex post factu

Recall, there must be some dealing in the goods that gives rise to proceeds. A security interest automatically, by operation of law (section 25), attaches to proceeds. The security interest attaches to proceeds that are identifiable and traceable. "Identifiable" apparently relates to the ease of identification – for instance, something in the nature of a trade is likely identifiable. "Traceable" is a difficult concept that relates to money – the issue becomes what is meant by traceable? The word 'trace' has a history in the common law jurisprudence. It could be tracing at law or tracing at equity, it could be subrogation as tracing, or it could be some special type of tracing (PPSA tracing). Which rules apply in the PPSA cases? This area of law is still under development.

A couple of general rules to note:

1. You do not need a trust relationship to get into a mixed bank account;
2. Tracing does not stop at a bona fide purchaser without notice for value unless you can find some section of the Act that says it should stop;
3. If you can trace into a mixed bank account and there is always sufficient money to satisfy the claims, you will get your money;
4. If you can trace into a mixed bank account and there is not sufficient money to satisfy the claims, you must consider which rule is most appropriate to divide it up: FIFO, LIBR, etc.,

Flexi-Coil v. Kindersley District Credit (1993) Sask CA

Facts	Holding	Ratio
o A bank is attempting to exercise its set-off rights (applying money in existing accounts with the bank against any money owed) o A secured party is up against the bank o The debtor here is Churchill o The secured party is Flexi-Coil – it had sold inventory to Churchill and retained a security interest (a financing statement was filed) o Flexi-Coil argues it has a perfected security interest in any proceeds o Churchill received a number of	o Section 28(4) provides that a purchaser of instruments or documents of title takes it free and clear of any security interest if they give value without knowledge and take possession o Value was given for the cheques (used to set-off – even past consideration is good for value) o The bank argues that it did not know about the security interest o Because the bank gave value and did not know about the security interest, section 28(4) may be	o A purchaser of an instrument or document of title may take free and clear so long as: o Value is given; o The purchaser has no knowledge of the security interest; and, o The purchaser takes possession

cheques for the sale of inventory o The cheques were deposited in the Credit Union (bank)	applied to let the bank take free and clear o	

Transamerica Commercial v. Royal Bank of Canada (1990) Sask CA

Facts	Holding
o Cheques were deposited into a positive balance account o Bank applied the amount to an existing debt without the debtor's authorization	o The proceeds secured party was allowed to trace the proceeds to the account and beat the Bank

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Miscellaneous Issues

Fixtures

By definition the PPSA deals with personal property and not real property. The problem with fixtures is that we have personal property that becomes real property by virtue of affixation with the land. Any personal property affixed to the land becomes part of the land. Thus, if someone purchases the land s/he buys that property attached to it.

The problem is that if X is a secured party who has a security interest in personal property and that personal property becomes affixed to the land, what is X's position as a secured party against any occupants/owners of the land?

The first question that comes up is whether or not at the end of a lease a tenant can remove personal property that s/he has affixed to the property during the leasing period? The court will look at the purpose for which the affixation took place.

Does it matter whether the personal property is a trade fixture vis-à-vis a landlord? Section 34 of the Act sets out the rules for fixtures and covers all kinds of fixtures.

859587 v. Starmark (1998) ON CA

Facts	Holding
○ Not Done	○ The landlord has the right of distraint against personal property for arrears of rent ○ There is no right of distraint against real property

Present Owners

A distrainting landlord will beat a perfected secured party. If, however, bankruptcy occurs then the secured party beats the landlord.

Section 34(1) of the Act provides:

> A security interest in goods that attached,
> (a) Before the goods became a fixture, has priority as to the fixture over the claim of any person who has an interest in the real property; or
> (b) After the goods became a fixture, has priority as to the fixture over the claim of any person who subsequently acquired an interest in the real property, but not over any person who had a registered interest in the real property at the time the security interest in the goods attached and who has not consented in writing to the security interest or disclaimed an interest in the fixture.

If X is taking a security interest in something that is a fixture, than X is not going to have priority over present owners of the real estate unless their consent is obtained.

Subsequent Owners

What do you do about subsequent owners of the real estate? The secured party ought to register something on the land registry and if the secured party does not s/he will be subordinate to the bona fide purchaser for value without notice. A secured party can file a notice of lien on the land registry, which

will protect the interest against subsequent owners. Section 34(1)(b) must be read in light of section 34(2):

> A security interest mentioned in subsection (1) is subordinate to the interest of,
> (a) a subsequent purchaser for value of an interest in the real property; or
> (b) a creditor with a prior encumbrance of record on the real property to the extent that the creditor makes subsequent advances,
>
> if the subsequent purchase or subsequent advance under a prior encumbrance of record is made or contracted for without knowledge of the security interest and before notice of it is registered in accordance with section 54

A final category is building materials – someone supplying building materials to be used in the building of a house and is so doing on credit, there is not much point in obtaining a security interest in it because building materials are excluded from the PPSA.

Hypothetical – Dodson Construction

The first thing to be decided is which of these things have become fixtures and which have not? Those things that are still personal property then you apply any of the regular rules of the PPSA as we have done up until this point. If a financing statement was filed, then we have to ask whether there is any section that might help Jason. Perhaps section 28(1) is applicable – a buyer in the ordinary course of business. Insofar as some of these things have become fixtures, section 34 will apply. It is very likely that these security interests attached before these things became fixtures. The supplier of the fixtures would then have priority over those fixtures. Could Jason still fall back on section 28(1)?

Section 30(6) – Continuous Perfection

Section 30(6) provides:

> "Where a security interest that is perfected by registration becomes unperfected an is again perfected by registration, the security interest shall be deemed to have been continuously perfected from the time of first perfection except that if a person acquired rights in all or part of the collateral during the period when the security interest was unperfected, the registration shall not be effective as against the person who acquired the rights during such period"

The language of the new PPSA is passive and, therefore, can include rights acquired without any positive action by the affected person including just moving up in priority. Moving up in priority alone is not acquiring rights in the collateral.

Heidelberg Canada Graphic Equipment v. Arthur Anderson (1992) ON Gen Div

Review this self

Hypothetical – Rights in the Collateral

While the person did not acquire rights in the collateral, there was detrimental reliance. Is detrimental reliance sufficient to trigger subsection 30(6)? It is unlikely to trigger 30(6).

Circular Priority

Circular priority is a common concept. The classic PPSA internally generated circular priority problem is where SP1 has a perfected security interest that later becomes unperfected (lapse, transfer of collateral, etc.,) and upon realization re-perfects (filing a financing change statement, filing a new financing

statement etc.,). SP2 acquired rights in the collateral during the second perfected period of SP1. During that middle time, however, SP3 has acquired a perfected security interest. How are the proceeds to be distributed? Another type of circular priority is one that arises by virtue of statute – an externally generated circular priority.

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Enforcement

Before a security interest can be enforced there must be default. Also, when default occurs there are three general types of remedies:

1. Secured party's remedies against the collateral (take possession, sell or close on the collateral);
2. Secured party's remedies against the debtor (personal actions on the debt against the debtor); and,
3. Actions against the secured party

Remedies Against the Collateral

Taking Possession

Waldron v. Royal Bank (1991) BC CA

Facts	Holding
o During the recession of the 1980s financing institutions became very antsy and started calling loans o The issue became how much time, if any, does the secured party have to give the debtor to try to arrange alternative financing o Common law position – you had enough time to get the money and give it to the creditor	o A 'reasonable time' must be given o Reference was made to the factors set out in Lister v. Dunlop

Lister v. Dunlop (1982) SCC

Facts	Holding
o Not Done	o Factors to be considered as to the reasonable length of time between notice of intention to seize and actual seizing: 1. Amount of loan 2. Risk to creditor of losing their money or security 3. Character and reputation of the debtor 4. Potential of the debtor to raise money in a relatively short period of time 5. Circumstances surrounding the demand for payment 6. Other relevant factors o Prima facie, the common law rule is 1 day, but it is more like 5 days

Assume that default has occurred. Then we must look to section 62 of the Act, which provides:

> "Upon default under a security agreement
>
> (a) the secured party has, unless otherwise agreed, the right to take possession of the collateral by any method permitted by law;
> (b) if the collateral is equipment and the security interest has been perfected by registration, the secured party may, in a reasonable manner, render such equipment unusable without removal thereof from the debtor's premises, and the secured party shall thereupon be deemed to have taken possession of such equipment; and,
> (c) the secured party may dispose of collateral on the debtor's premises in accordance with section 63."

What is meant by the 'right to take possession'? How does the law work this concept out? If X takes possession of something from Y and X threatens etc., X will likely be committing some criminal offence

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At the very least, X is likely to be committing some offence (tort). *Issue*: How far does the law of re-caption go toward aiding the secured party in re-capturing the collateral? The law of re-caption takes the form of a defense against an action framed in tort or criminal law

R. v. Doucette (1960) ON CA

Facts	Holding
○ A television set was repossessed and force was used ○ A charge of assault was brought against the three bailiffs	○ Re-caption must be peaceable ○ The law of re-caption will not defend against re-caption unless it is peaceable

The secured party has a right to immediate possession of the collateral. *Note*: the common law has given the secured party the right to nominally trespass in order to re-capture the collateral.

Rapid Transit v. Commcorp Financial (1998) Alta CA

Facts	Holding
○ Not Done	○ Does the court have power to restrict the secured party's right to immediate possession? ○ The judge does not have that power

One of the things that the secured party is going to do is send in a receiver. The receiver is nothing more than a bailiff – if refused permission to enter the premises s/he cannot use force. In this case, you must get a judicial remedy. In the case of a receiver you should get a court appointed receiver. Since appointed by the court, if the debtor does anything to obstruct the receiver that is contempt of court. However, the court-appointed receiver owes a duty to *all* the stakeholders (it is longer, more expensive and more cumbersome).

Selling the Collateral

There is a statutory power of sale and this sale must be commercially reasonable in all respects. Any time you get a power of sale, you must ask what is it that the person purchasing is buying? Section 63(9) provides:

> Where collateral is disposed of in accordance with this section, the disposition discharges the security interest of the secured party making the disposition and, if the disposition is made to a buyer who buys in good faith for value, discharges also any subordinate security interest and terminates the debtor's interest in the collateral.

What about a buyer from a secured party under section 63? Note that there are a number of notices that must be given along with time limitations etc., Does the buyer have to review and ensure that all the notices and limitations were properly taken care of? Consider section 63(10):

> "Where collateral is disposed of by a secured party after default otherwise than in accordance with this section, then,
>
> (a) in the case of a public sale, if the buyer has no knowledge of any defect in the sale and if the buyer does not buy in collusion with the secured party, other bidders or the person conducting the sale; or
> (b) in any other case, if the buyer acts in good faith, the disposition discharges the security interest of the secured party making the disposition and, where the

> disposition is made to a buyer for value, discharges also any subordinate security interest and terminates the debtor's interest in the collateral."

Remedies against the Debtor

Section 64(3) provides:

> "Unless otherwise agreed in the security agreement, or unless otherwise provided under this or any other Act, the debtor is liable for any deficiency"

Section 66(1) provides that the debtor has the right to redeem. If default occurs, the debtor has the right to come up with *all* the money – if this is possible default probably should not have occurred. Sections 66(2) and 66(3) provide the right to re-instate. The debtor can repay what s/he owes in addition to any incidental costs.

Rights Against the Secured Party

The secured party can be liable for conversion and wrongful seizure of default has not occurred. The statute sets up a number of statutory liabilities as well. For instance, section 59(3) provides:

> "Where the debtor is in default under a security agreement, the debtor has the rights and remedies provided in the security agreement and the rights and remedies provided in this Part and in section 17"

Section 59(4) provides standards relating to what the secured party can do. So long as those standards are reasonable and contracted for, they will be binding:

> "Subject to subsection (5), a security agreement may set out the standards by which the rights of the debtor and the duties of the secured party are to be measured, so long as those standards are not manifestly unreasonable having regard to the nature of the rights and duties"

Section 16 provides an acceleration provision purporting to control acceleration, which must be exercised in good faith:

> "Where a security agreement provides that the secured party may accelerate payment or performance if the secured party considers that the collateral is in jeopardy or that the secured party is insecure, the agreement shall be construed to mean that the secured party may accelerate payment or performance only if the secured party in good faith believes and has commercially reasonable grounds to believe that the prospect of payment or performance is or is about to be impaired or that the collateral is or is about to be placed in jeopardy"

Under section 34(3) we see a secured party liable for damages against real property caused by the removal of a fixture resulting in surround damage:

> "If a secured party has an interest in a fixture that has priority over the claim of a person having an interest in the real property, the secured party may, on default and subject to the provisions of this Act respecting default, remove the fixture from the real property if, unless otherwise agreed, the secured party reimburses any encumbrance or owner of the real property who is not the debtor for the cost of repairing any physical injury but excluding diminution in the value of the real property caused by the absence of the fixture or by the necessity for replacement"

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There are a number of sections making a secured party liable in damages and setting the minimum damage at $500. Consider section 57(2) relating to the failure to register:

> Where a secured party fails to comply with subsection (1), the secured party shall, on written notice from the debtor, pay the debtor $500 and any damages resulting from the failure, which sum and damages are recoverable in any court of competent jurisdiction.

Section 60(2) and 67(1) provide provisions relating to where a dispute arises the Ontario Superior Court is given jurisdiction to settle the dispute.

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Conflict

Conflict is something that can and does cause problems in litigation. In giving opinions concerning PPSA to a client, the lawyer must be very careful in opining that the client has the first priority in the collateral.

The sections that deal with conflict are located at 5 through 8 of the *Act*. These sections are generally uniform across the common law provinces. The rules used to be substantially similar to the UCC, but two years ago the UCC was revised and changes were made to the conflict sections.

Section 5

Section 5(1) of the *Act* provides as follows:

> Except as otherwise provided in this Act, the validity, perfection and effect of perfection or non- perfection of,
> (a) A security interest in goods; and,
> (b) A possessory security interest in a security, an instrument, a negotiable document of title, money and chattel paper, shall be governed by the law of the jurisdiction where the collateral is situated at the time the security interest attaches

The idea is that when you are dealing with goods or a possessory security interest, the easiest thing to decide is the location of the goods. The law of the location of the goods should apply, but when? The section provides when the security interest attaches. In other words, the law of a particular jurisdiction will apply to goods located in that jurisdiction at the point in time that the security interest attaches.

Assume that 5(1), 6(1) or 7 has been applied and you have filed in the proper place. However, the goods now change jurisdiction – moved to Ontario.

Section 5(2) provides:

> 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 Ontario continues perfected in Ontario if a financing statement is registered in Ontario before the goods are brought in or if it is perfected in Ontario,
> (a) within sixty days after the goods are brought in;
> (b) within fifteen days after the day the secured party receives notice that the goods have been brought in; or
> (c) before the date that perfection ceases under the law of the jurisdiction in which the goods were situated at the time the security interest attached, whichever is earliest, but the security interest is subordinate to the interest of a buyer or lessee of those goods who acquires the goods from the debtor as consumer goods in good faith and without knowledge of the security interest and before the security interest is perfected in Ontario.

If the goods have come from a jurisdiction where the interest is perfected and it comes into Ontario, the statute gives a maximum of 60 days to register in Ontario.

What happens if goods come into Ontario on day one and on day 50 X buys the goods or bankruptcy occurs? On day 70 a financing statement is filed – is the trustee in bankruptcy or the purchaser subject to the security interest? If the interest remains perfected in Ontario for 60 days – then it was purchased while perfected. However, if after 60 days we have a retroactive unperfection then the security interest will not apply. The courts have held that the 60 days is a retroactive unperfection. Thus, although

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perfected goods were purchased in Ontario within 60 days of transport, unless there is registration within those 60 days the security interest will not apply.

There is some protection in the provisions at 5(2)(c). You cannot expect a buyer of consumer goods to be aware and require a search to be conducted. However, in the case of non-consumer goods you have to worry about these provisions.

Section 6

Section 6(1) of the *Act* provides as follows:

> Subject to section 7, if the parties to a security agreement creating 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 the goods are removed to that other jurisdiction, for purposes other than transportation through the other jurisdiction, within thirty days after the security interest attached, the validity, perfection and effect of perfection or non-perfection of the security interest shall be governed by the law of the other jurisdiction

Hypothetical – Alpha & The Machine

A machine is being manufactured in Ohio and is to be installed in a paper-making plant in B.C. Alpha is lending the money to pay for the machine and they are taking a security interest in it to secure the loan. The security interest will attach while in Ohio. The first impulse would be to apply section 5 and conclude that since the security interest will attach in Ohio the registration should occur in Ohio. This is a situation where section 6 will apply. It is understood that these goods are going to be removed from Ohio and shipped permanently to B.C. If those goods get to B.C. within 30 days from the date of attachment, then the registration should occur in B.C.

To what extent can we trust these provisions? Suppose that on the way to B.C. from Ohio, the goods are seized in Kansas as per a judgment. What if the goods, for some reason, do not get to B.C. within 30 days although scheduled to so arrive? The safest bet might be to register in both jurisdictions.

Note: it appears that section 5 is subject to section 6 (it says subject to other sections of the Act). Section 6 is subject to section 7. Section 6, in other words, will be deemed paramount over the section 5 provisions.

Section 7

Section 7(1) of the Act provides:

> The validity, perfection and effect of perfection or non-perfection,
> (a) of a security interest in,
> (i) an intangible, or
> (ii) goods that are of a type that are normally used in more than one jurisdiction, if the goods are equipment or inventory leased or held for lease by a debtor to others; and
> (b) of a non-possessory security interest in a security, an instrument, a negotiable document of title, money and chattel paper, shall be governed by the law of the jurisdiction where the debtor is located at the time the security interest attaches.

Section 7(2) addresses what happens if the debtor changes his/her location.

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Hypothetical – Alpha & Echo

Alpha is lending money to various people and taking security interests. Alpha finances Ecco Ltd, which is in the business of selling photocopiers. Ecco's head office is in Winnipeg, but its manufacturing plant is in Ohio. Alpha has an interest in all present inventory and after-acquired accounts. Where would you file the financing statement? It appears that section 5(1) should apply – location of the collateral at the time of attachment. However, depending on where that inventory is coming from then one might have to look at section 6. What about the accounts? The accounts clearly are an intangible, thus section 7 will apply. The financing statement should be filed in the location of the debtor. Section 7(4) provides where the location of the debtor is:

> For the purpose of this section, a debtor shall be deemed to be located at the debtor's place of business if there is one, at the debtor's chief executive office if there is more than one place of business, and otherwise at the debtor's principal place of residence

The chief executive office is where the principal management functions take place.

Alpha is lending to a dentist, who practices in Ottawa but lives in Quebec, for the financing of an airplane. Section 7 would pick up the airplane as a mobile good. However, section 7 is applicable only if the goods are classified as equipment or goods held for lease or inventory lease. The plane is not held for lease, but does the dentist have the goods by virtue of a lease? If the dentist is leasing the plane, then section 7 is likely going to apply. You have to ask yourself whether this is a true lease. Uncertainty raises its head – if the dentist is financing the plane, then section 7 will not apply and we will look to the location of the goods at the time of attachment. However, if we have a true lease, then Alpha will have to file where the dentist resides. Another problem is the fact that you file at the debtor's place of business, if there is one. Does this mean you file where the office is – in Ottawa? Because of the uncertainty it would be best to file in both places. If bankruptcy occurs and you have not filed in one of the jurisdictions, some lawyer somewhere is going to question it.

Hypothetical – George & The Windsor Car

On December 15 the car comes into Windsor and on January 15 it is sold to Larry. On February 5 it is perfected in Ontario. The good is perfected within 60 days and Larry will be protected so long as the car can be classified as consumer goods. If Larry was not an individual, but instead a corporation then there would be a massive difference. Section 5(2) would be applicable and the interest is perfected within the 60-day period.

Section 8

A real problem that does come up is the choice of law. What law is applicable when you are trying to enforce the security agreement? Consider section 8(1), which deals with substantive and procedural issues:

> Despite sections 5, 6 and 7,
>
> (a) Procedural matters affecting the enforcement of the right of a secured party in respect of collateral other than intangibles are governed by the law of the jurisdiction in which the collateral is located at the time of the exercise of those rights;
>
> (b) Procedural matters affecting the enforcement of the rights of a secured party against intangibles are governed by the law of the forum; and

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(c) Substantive matters affecting the enforcement of the rights of a secured party against collateral are governed by the proper law of the contract between the secured party and the debtor.

If you have a security agreement signed in Alabama and perfected in Alabama, but the debtor later relocated to Ontario and an action is brought against the debtor in Ontario. Section 8(1) requires that the parties look to the issue and on a specific issue deem whether you have a substantive issue of enforcement or a procedural issue of enforcement.

Gimli v. BDO Dunwoody (1998) Alta CA

Facts	Holding
○ Secured party had a true lease, which had been entered into in Manitoba ○ The goods had been relocated to Alberta and another good had been relocated to BC ○ In Manitoba (at the time) the law was that a true lease did not have to be registered – in Alberta and BC you did have to register	○ The court said that Alberta law applies because this is a substantive issue

In Ontario you can seize and sell, but in B.C. you cannot. What law applies? If it is procedural the answer is Ontario, if substantive then B.C. The fact that an action is taken away from a third party is substantive – the proper application is a consideration of where the contract was made. Note: Section 5 through 8 apply no matter what the parties have chosen.

Hypothetical - Alpha & the Airplane

An airplane is certainly used in more than one jurisdiction – section 7? In order to bring in section 7 it has to be either equipment or acquired through a lease. If you can characterize it as equipment then you can apply section 7 of the *Act*.

Summary

Section 5(1) – location of the goods at date of attachment
Section 5(2) – problem of change of jurisdiction
Section 6(1) – if there is an understanding of change of jurisdiction within 30 days
Section 7(1) – location of the debtor
Section 8 – deciding between a procedural matter and a substantive matter

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Bank Act Security

In order to facilitate the financing of primary industry in Canada in the late 19th century a security interest was set up under the *Bank Act* – banks could lend money to this type of enterprise and can take a security interest under a prescribed set of rules. Nobody knew what to call these provisions, which were found, at section 88 – it was later called a section 88 security. As the economy developed and changed more additions were made to the provisions in order to allow banks to lend to different types of enterprise. The most recent amendment is found at section 427. There is a very broad range of collateral and the types of persons to whom the bank may lend money.

Section 427

Security under the bank act is provided for in s.427 and 428. When is security available under s.427? This section is only applicable to banks. The bank cannot use s.427 in every circumstance, depends on the customer giving security. Who can give security to a bank?

- Dealers in goods/wares/merchandise (ie/ retail store)
- Manufacturers of goods/wares/merchandise (ie/ General Motors)
- Farmer
- Fisherman

Security can be given on what the manufacturer manufactures, and what it uses to pack those goods/wares/merchandise, but nothing else (ie/ a farmer can include agricultural products, crops, livestock, but no other asset). All three requirements must be met to give security under s.427.

How does the bank take security? Notice of intention to take security – bank must register notice with the Bank of Canada. If the notice is not registered, then the rights and powers of the bank are void against creditors, subsequent purchasers or bona fide mortgages under the Bank Act. Having registered notice, the customer usually gives the bank the security (signs document); must be in this order (unlike PPSA where registration can occur before or after signing). The actual security takes the form of a scheduled assignment.

Section 427(3) provides the bank's remedies in case of default- gives clear right to possession in non-payment, failure to care for collateral, attempt to dispose of collateral without consent.

Section 428(7) provides a right to sell collateral upon non-payment.

Section 428(8) provides the right to apply for sale of collateral in event of default - must have a public auction.

Section 428 also deals with duties of the bank- sale must be commercially reasonable under the PPSA; here the bank must act honestly and in good faith in a timely and appropriate manner regarding the nature of the collateral.

Section 428(11) bank has a positive duty to sell collateral as soon as is reasonably possible or practical in a timely and appropriate manner.

There are four primary documents to consider:

1. File notice within three years (only public document);
2. Promise to give;
3. Assignment; and,

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4. The agreement between the bank and the borrower

Effect of Taking Security

Section 427(2) provides that delivery of a document under the Act vests in the bank in respect of the property therein described of which the person giving over is the *owner* at the time of delivery or any time thereafter (after-acquired property). The bank gets the rights in whatever the person has – they use the concept of ownership. Note: the word *owner* is not defined in the Act.

427(2)(c) – the bank gets the same rights and powers as if the bank had required a warehouse receipt or bill of lading.

If X owns goods and the bill of lading is sold to Y, Y owns the goods. Does the bank become owner of the goods in acquiring rights under 427(2)(c)? No, the security secures the loan and, thus, it must be in the nature of a mortgage. The bank has legal title while the debtor has something like the equity of redemption.

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Repair and Storage Lien Act

This is a similar statute to the *PPSA* and it is used nearly everyday. The *RSLA* came into effect in 1989. However, the *RSLA* is not as well drafted as the *PPSA*. It might be persuasive to review the *PPSA* jurisprudence where the provisions are substantially similar.

The purpose of the *RSLA* is to take what used to be 'repairer's liens' or 'workmen's liens' in the common law and sweep them into an Act in order to set up a system of priorities. At common law, the liens were basically liens that provided an entitlement to possession. In some cases, although very seldom, the common law lien provided the right to sell. The second purpose of the Act was to give repairers rights with minimum filing requirements and sophistications. Another purpose is to provide dispute resolution mechanisms.

Structure of the Act

Part I – Possessory Lien
Part II – Non-Possessory Lien
Part III – Enforcement
Part IV – Dispute Resolution
Part V – General

Part I – Possessory Lien

Section 3

Section 3 of the *Act* provides that in the absence of a written agreement to the contrary the lien will arise by operation of law. The repairer may retain possession of the article until the amount owing is paid. The lien arises where the repair begins and the possessory lien ends when the repairer surrenders possession. Once the chattel is surrendered taking possession again cannot revive the lien. While a repairer is working on the machine he has a possessory lien, when s/he is finished s/he has the right to remove or take possession.

Section 4

Section 4 provides that the storer's or repair and storer's lien arises when possession is gained by the storer and ends when possession is surrendered. Where a storer has reason to believe that the storer is not owner of the goods, then he must give notice to persons with security interests and liens. Subsection 5 provides that if somebody ought to get notice but does not get it, then the lien will only last for 60 days – this gives the storer 60 days to get the notice out.

Section 6

A possessory lien under this part has priority over the interests of all other persons in the article. A possessory lien has priority over a security interest or a trustee in bankruptcy.

Part II – Non-Possessory Lien

The non-possessory lien will replace the possessory lien where the goods are surrendered. If the owner of the article has possession, but the repairer has a property right (separation of property right and possession) then we should be looking for exceptions to the *nemo dat* rule.

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Section 7

Subsection 3 provides that the non-possessory lien has priority over everyone except for someone who has a possessory lien. Subsection 5 provides that a lien is not enforceable unless a signed acknowledgment of the indebtedness is acquired. Subsection 6 provides that even if the acknowledgment is signed it can still be disputed later on.

Section 8

Section 8 provides that a buyer in the ordinary course of business of a seller takes free of a lien created by the seller, unless the buyer acknowledges the debt. If a wholesaler sells to a retailer in the ordinary course of business the retailer will take free and clear unless the retailer acknowledges the lien, but if the retailer sells to a customer, the customer takes free and clear even if there was an acknowledgment from the retailer to the wholesaler.

Section 9

You can register a claim for lien. Subsection 2 provides the exact same curative section found in section 46(4) of the *PPSA*.

Whose name do you put into the RLSA forms? The forms ask for a 'debtor', but the Act does not use the term. Thus, you use the owner.

What is included in the concept of 'repair' – an expenditure of money for the purpose of altering, improving, restoring properties, or maintaining properties.

Section 10

You cannot register a claim until after the acknowledgement is signed. The term of the lien is a maximum of three years. Note: The lien can be assigned.

Section 12

A lien is discharged if the debt is paid, by order of the court, a financing change statement, etc., If a claim for lien is not registered before the change of ownership of a vehicle, then the lien will not apply.

Section 13

Provides the court the jurisdiction to amend the registry insofar as liens are registered there.

Section 14

A lien claimant who has a non-possessory claim can give the sheriff the direction to seize goods. Normally a sheriff only moves on the order of a court. Subsection 5 provides the power of sale.

Section 16

Once the power of sale has been exercised, what should be done with the proceeds of the sale? Section 16 provides the expenses of the sale and any costs should be paid out. Then money should be paid to the

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last person who added value (people with liens in the reverse order of them having surrendered possession – last shall be first) and move to the first.

Section 18

If there is seizure of foreclosure, no deficiency claims. If a repairer or storer owes money that exceeds value of that which is being repaired and if the person who owns the article has money, the repairer will be better off forgetting the lien and starting an action for the value.

Section 20

Although a lien claimant has failed to comply, a purchaser who buys an article in good faith in a sale or foreclosure acquires the article free of the interest of the owner. If there is an unauthorized delivery for repair or storage and the repairer or storer can sell the item, anybody who buys can take good title whether or not the original delivery was authorized or not. The storer or repairer only has to give notice if s/he has reason to believe that the deliverer is not owner or unauthorized.

Section 31

This section gives the sheriff the right to use reasonable force.

What are the priorities between the *PPSA* and the *RSLA*? There are a couple of sections in the PPSA that deal with this. For instance, section 4 tells us what is not included in the PPSA – the Act does not apply to a lien created by statute, except as provided in 20(a)(i) and 31.

20(a)(i) – an unperfected security interest loses to a lien or other lien given by law

Section 31 - Where a person in the ordinary course of business furnishes materials or services with respect to goods that are subject to a security interest, any lien that the person has in respect of the materials or services has priority over a perfected security interest unless the lien is given by an Act that provides that the lien does not have such priority.

A repairer's lien beats a perfected security interest unless the statute says otherwise. The RSLA under 10(1) provides that if the claim for lien repair is not registered

Where there is a conflict between the PPSA and any other statute, the PPSA wins.

Problems arise where you have a organization and their business is to repair fleets of trucks, railway cars, buses, etc., and they come in on regular intervals, are repaired, and then go back out. There is nothing in the RLSA like 46(4) of the PPSA.

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Unsecured Creditors

The whole point about a secured creditor is that if a creditor is not paid, then the creditor has a right to look to some property to satisfy all or part of the debt. Thus, you are better off to be secured than to be unsecured. Most trade creditors, however, are unsecured creditors – suppliers of inventory, equipment, etc., are traditionally unsecured. When we speak of unsecured creditors we are speaking of more than just people who are owed a debt. A debt connotes a clearly identifiable sum – a liquidated debt. A liquidated debt usually arises from money lent and goods supplied as specified in an agreement. However, there are also non-liquidated claims. The claim has not yet been liquidated and, thus, remains non-quantified. Claims for breach of contract are generally non-liquidated claims that become a judgment debt upon order of the court. The important thing to remember is that you only really have a debt once you know how much is owed.

An unsecured creditor does not have the right to realize upon property. An unsecured creditor will have to get judgment in order to realize upon property. Judgment is gotten from a court of competent jurisdiction either with or without a trial. The idea is that with that judgment you would seek to enforce the judgment against the property of the judgment debtor.

Writs of Execution

Historically, under the writs of *capias ad satisfacienden* (the writ of *casa*) the debtor could be put in jail until the debt was paid. This is no longer the case – under Rule 60.05 of the *Rules of Civil Procedure* a debtor cannot be imprisoned for the non-payment of a debt. However, if you do not appear at the judgment debtor examination you may be imprisoned for contempt of proceedings.

After having obtained a judgment the proper writ must be issued by the court. The most common writ for our purposes is the writ of seizure and sale (Form 60A). This writ used to be called the writ of *fiere facias*, which was the workhorse of execution creditors (the writ of *fifa*). After obtaining judgment you have to file with the registrar in order to obtain the writ of seizure and sale. At this point you are regarded as an execution creditor.

Unsecured Creditor ⟶ Judgment Creditor ⟶ Execution Creditor

Generally, you will take that writ and deliver it to the sheriff. At that point it is said to be filed in the Sheriff's office and the binding effect comes in.

There are other writs of execution that order payment or the recovery of money:

1. *Writ of sequestration* – sheriff may take possession and hold property or income until some further order;
2. *Writ of possession* – sheriff may enter and take possession of land or premises and give such possession to person named; and,
3. *Writ of delivery* – sheriff may seize possession of personal property and deliver to person named.

Consequences of Filing the Writ of Seizure and Sale

Under Rule 60.06 the writ of seizure and sale has a life of six years, which under rule 60.08 may be renewed. You see under Rule 60.07(13) the right to enforce. Once the sheriff seizes s/he then proceeds to sell. When the sheriff sells and gets money back it is said to be a levy. The levy triggers the *Credit Relief Act* – the money gotten by the sheriff, after paying his or her expenses, shall be paid for 60 days under the *Act,* after which it shall be paid to all execution creditors in the county and any other creditors

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who appear and have filed a certificate where the debt is not contested by the judgment debtor. Likely, the creditor who got all this moving is not going to get all the money. The executing creditor who issues the writ may have to share the value of the asset with other creditors.

Effect of Writ of Execution on Lands of Debtor

What is the effect of the writ upon the land owned by the execution debtor in the county? Section 9 of the *Execution Act* provides:

> A sheriff to whom a writ of execution against lands is delivered for execution may seize and sell thereunder the lands of the execution debtor, including any lands whereof any other person is seized or possessed in trust for the execution debtor and including any interest of the execution debtor in lands held in joint tenancy.

Section 13 and 29 of the *Act* are also relevant as they deal with liability of land to execution and the contingent interest in land. The writ is capable reaching just about any interest in land. Note, however, section 10 of the *Act*, which provides:

> Subject to the Land Titles Act and to section 11, a writ of execution binds the goods and lands against which it is issued from the time it has been received for execution and recorded by the sheriff.

Thus, if you are acting for X who is going to buy a piece of real estate, you are going to search the title to the land to ensure that there are no outstanding encroachments or liabilities. In the registry system you ought to search in the sheriff's office because section 10 of the *Executions Act* provides that a writ filed in the sheriff's office binds the land.

Suppose an owner of land has a mortgage on his/her land. The mortgagee retains legal title and the mortgagor and retains an equity of redemption. Can you reach an equity of redemption with a writ of seizure and sale? Section 28 provides that you can seize and sell an equity of redemption. When the sheriff sells and you buy this land from the sheriff from a sheriff's auction, you will buy that land subject to the mortgage – you will pay what the mortgage is worth and continue on with the payments. The equity of redemption is bound when the writ is filed in the sheriff's office.

Is a mortgage an interest in land, which is bound when the writ is filed? If you look at sections 23 and 24 of the *Executioner's Act*. Section 23 contemplates that a mortgage is not contemplated upon the filing of the writ with the sheriff, but rather when notice is filed with the registry office. How do you reconcile section 23 with section 10? A mortgage, for the purposes of execution, is seen as personal property.

Under Rule 60.07(17)(18) and (19) you will see a requirement for notices of seizure, but there is a four-month delay from the date the writ is filed. There is no sale until after six months of the writ filing. What if land is held in joint tenancy and there is a writ of execution against one of the tenants? The creditor will lose to the right of survivorship until the joint tenancy is severed.

Effect of Writ of Execution on Goods of Debtor

Section 10(1) says that lands and goods are bound by the writ of execution. Section 10(2) provides that bona fide purchasers for value without notice take free and clear of that execution. If X is going to take a security interest in Y's goods, should X conduct a search in the sheriff's office? No, so long as X still has possession of the goods. Recall, one is only subordinate to the writ of execution if the sheriff has the goods in his or her possession.

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Section 18 of the Act provides that the seller may sell whatever the execution debtor has, unless a statutory provision provides otherwise. Therefore, if you are contemplating buying something at a sheriff's sale, you ought to conduct due diligence searches – the sheriff makes absolutely clear that there are no warranties on title – things are sold completely as is.

Effect of Writ of Execution on Accounts

Section 19(2) and (3) provide that:

> (2) The sheriff may seize any book debts and other choses in action of the execution debtor and may sue in his or her own name for the recovery of the money payable in respect thereof
>
> (3) If it appears to the sheriff that an attempt to collect the book debts, choses in action or the securities for the money referred to in subsections (1) and (2) would be less beneficial to the creditors than a sale thereof, the sheriff may proceed to sell such book debts, choses in action and securities by public auction in the same manner as the debtors' goods may be sold when taken in execution

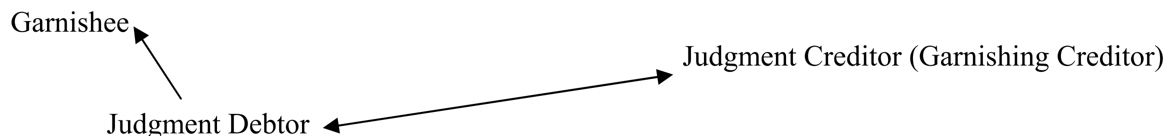
Section 19(1) indicates that the sheriff may seize cheques, bank notes or *other* evidence of debts. Sections 14, 15 and 16 provide that the sheriff can seize any interest in a share – the method of seizure is there provided. Even non-transferable shares can be seized. Can the sheriff sell – note: the sheriff cannot sell any interest that the debtor did not have. In a closely held corporation the debtor would not have been able to sell the share, thus, the sheriff will not be likely to sell the share.

Exemptions from Seizure

Within the last year the exemptions were changed. Any items exempt do not vest in the trustee in bankruptcy, the bankrupt may keep them.

Garnishment

Garnishment is a common form of realization upon a judgment – it is done under Rule 60.08. Approximately 10-12 years ago the garnishment tool was revamped. This is a method whereby an unsecured credit can collect, but it is subject to the *nemo dat* rule.



The garnishing creditor goes to the court and, as a matter of right, gets a notice of garnishment. The notice of garnishment is served upon the garnishee and the judgment debtor. The notice requires the garnishee to pay the money in the court, which will be distributed pursuant to the *Creditor's Relief Act*. The notice also provides that if the monies are not paid, judgment will be ordered against him/her for the money. The garnishee is also required to instruct the court as to whether anybody else has an interest in that money.

Rule 60.08(12) provides that:

> For the purposes of subrule (11), a debt of the garnishee to the debtor includes a debt payable at the time the notice of garnishment is served and a debt,
>
> (a) payable within six years after the notice is served; or,

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(b) payable on the fulfillment of a condition within six years after the notice is served.

All monies owed to the judgment debtor for the next six years will be paid into court until the judgment is paid. Subsection 13 takes away a bit of the mischief that can arise out of the enforcement of a garnishment.

Garnishment is generally used on wages, but it is also very useful if you have a judgment debtor who has an income on an estate. It used to be that you could not garnish a joint bank account – today, the rules have been amended to allow garnishment out of joint bank accounts.

However, garnishment is subject to the *nemo dat* rule so that if a secured party has a perfected security interest in the account, the secured credit beats out the garnishing creditor. Another common thing you might find is that there is a thing called a wage assignment – a portion of an individual's wages can be assigned to a Credit Union or Caisse Populaire. A wage assignment is a security interest in an account – when and if it becomes perfected it will trump a garnishment order.

Receivers

The secured party always has the right to send in a receiver. The Court may also appoint a receiver as per a security agreement – but it may appoint one for any purpose at all. The judge may order a receiver any time it is just and convenient to do so.

The *receiver in aid of execution* (equitable execution) is the most relevant for our purposes. This power to order a receiver is very handy where you have a debtor who is recalcitrant (intractable). This device raises the contempt jurisdiction of the court to enforce.

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Fraudulent Conveyances

As soon as a corporation or a person contemplates the possibility of a judgment or claim against them, the first thing they will do is try to render their assets judgment-proof. A fraudulent conveyance is a conveyance from the transferor to a third-party with the goal of making it unreachable from the point of view of a party looking to collect on the transferor. This may include the transfer of an asset from one type of property to another or transferring bank accounts offshore etc.,

A preference is different than a conveyance – this is where the judgment debtor owes a number of parties money, but s/he will only secure some of them. It is more than coincidence that the judgment debtor chooses to secure parties such as the spouse, relatives, bank etc., The preference takes the form of either paying a particular creditor or giving him/her a security interest. Can you ever attack a transfer to a creditor as a fraudulent conveyance?

Statutory Regime

Fraudulent Conveyances Act

Section 2 of the Act provides that every conveyance of real or personal property made with intent to defeat, hinder, delay or defraud creditors of their just and lawful actions are void as against such persons and their assignment (creditors or other).

1. There has to be a conveyance; and,
2. The conveyance must be made with the intent to defeat, hinder, delay, or defraud;

All of the elements of section 2 must be standing at the time of the conveyance. If you can show those things, the conveyance will be 'voidable' – until the court sets the conveyance aside it is a perfectly valid transfer.

Section 3 provides that section 2 does not apply to real or personal property conveyed upon *good* consideration and in good faith to a person not having, at the time of the conveyance, notice or knowledge of the intent set fourth in section 2. You will not be able to set aside the transfer if the transferee can show:

1. Good consideration;
2. Bona fide transfer; and,
3. No knowledge of the transferor's intent

Section 4 provides that section 2 applies to every conveyance set forth with the intent in section 2 unless it is protected by section 3. This section has been included to meet some case law that developed in the past.

Assignments and Preferences Act

This Act was passed in the 1880s in response to the repeal of the federal bankruptcy act. The provinces enacted legislation to fill the void, but they didn't have the power to legislation in regards to bankruptcy. Instead, the provincial government established a regime of assignments and preferences. This Act contained provisions to set aside fraudulent conveyances and preferences. In the early 1900s, the federal government enacted new bankruptcy legislation making the provincial legislation ultra vires. However, the assignments, conveyancing, and preferences provisions are not ultra vires and still in play today.

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Section 4(1) of the Act provides that subject to section 5 every conveyance over a payment of goods made by a person when insolvent or unable to pay debts in full, with intent to hinder, delay or prejudice creditors is void. We are really talking about fraudulent conveyances here. This is where you would attack a conveyance:

1. You must prove a conveyance;
2. The conveyance must be made while the debtor is insolvent or on the eve of insolvency;
3. The intent must be to hinder, delay or prejudice creditor;
4. In order to have standing to attack you must be a creditor at the time of the impugned conveyance; and,
5. You must prove the effect of the conveyance was to hinder, delay, or prejudice

In section 4(2) the intent turns to the intent to give another an unjust preference. This is where you would attack a preference.

Section 5 provides that nothing in section 4 applies to any sale or payment made in good faith in the ordinary course of trade or calling to an innocent purchaser or person nor to any payment of money to a creditor nor to any conveyance over of any goods as made in good faith or consideration of present and actual payment of money, sale, goods, or other property where those have a fair and reasonable value to the goods transferred there for.

Where the transferee can reach the safe haven (sale or payment in the ordinary course; payment of money to a creditor; or, a transferee who gave actual, present and adequate consideration). There are a number of elements:

1. You need a conveyance (this is very broad and includes the designation of a beneficiary);
2. Who has standing to attack? A creditor at the time of the conveyance. What about claimants? What about future creditors? What is meant by 'other'? 'Other' means a claimant at the time or a future creditor

Gauthier v. Woollatt (1940) ON HC

Facts	Holding	Ratio
○ Woolet purchased some land and had it registered in his wife's name ○ Molson's bank had a judgment against Woolet and the writ of fifa was sitting in the sheriff's office from 1924-1929 ○ Woollatt admitted that he put the property in his wife's name so that the writ would not attach to it ○ Gauthier's claim is on a promissory note due Jan 25, 1929 – this note was fully secured ○ Gauthier got judgment in 1934 and brings the action to set aside the transfer to the wife	○ *Issue*: Does Gauthier have standing to attack? ○ Gauthier was a fully secured creditor at the time – fully secured creditor is a creditor, but how can he attack the requisite intent? ○ If you can show that the transfer was made with the intent to delay, defeat, defraud future creditors – then those future creditors have standing to attack the transfer because those future creditors are 'others' ○ If a person makes a transfer with the intent to defeat, but then pays off all the creditors, it will be very difficult to attack	○ Standing requires that you are a creditor or other (future claimant) who can show a transfer with the intent to defeat, hinder etc., him/her

Being fully secured, how can he prove the intent was to hinder him? He was fully secured – the intent should not matter. Recall, the secured credit has the priority over the third party even.

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McKay v. *Douglas* – if you convey your assets to protect yourself from future creditors, the conveyance can be set aside.

If one is a future creditor (a creditor who did not exist on the date of the impugned transaction) an option are to prove the intent was to defeat, if you can convince the court of that you will get standing to move. The other possibility is to show that a creditor exists now that did not exist the day of the impugned transaction – the court will let you step in to that creditor's shows and give standing (a representative action).

Insolvency – you have to prove cash-flow insolvency or balance sheet insolvency. Balance sheet insolvency is the harder of the two to prove. Cash-flow insolvency entails showing that a creditor is not being paid off. If you can prove cash-flow insolvency, the onus shifts to the debtor to prove that his/her assets were sufficient (was not insolvent or on the eve of insolvency). Once cash-flow insolvency is proven there is an evidentiary onus put on the defendant to bring forward evidence of the balance sheet.

Proof of Intent

The requisite intent of the transferor must be proven. Section 2 of the *FCA* and 4(1) of the *APA* appears to be referring to the intent of the transferor. Once the intent is proven, the onus shifts to the transferor (defendant) to bring him or herself into safe haven. However, once valuable consideration has been given for the transfer, the transferor must prove that the transferee was *privy* to the fraudulent intent.

The onus is on the plaintiff to prove beyond a balance of probabilities. *Badges of Fraud* – circumstantial evidence that you would expect to find accompanying it some elements of fraud. These are elements of evidence that any thinking lawyer would call in order to show fraud.

If you can call enough badges of fraud:

1. It proves the plaintiff's case and it cannot be rebutted;
2. It is enough to prove the case, but the onus shifts to rebut; or,
3. It is no effect at all

Stewart feels the second notion is the most accurate.

Koop v. Smith (1915) SCC

Facts	Holding	Ratio
○ The badges of fraud were near a relationship	○ It is a maxim of prudence that a tribunal of fact may properly act upon that when suspicion touching the reality or the bona fides of a transaction between near relatives arises from the circumstances in which the transaction took place	○ Suspicious circumstances coupled with relationship make a case of *res ipso loquitor*

Freeman v. Pope (1870) Eng

Facts	Holding
○ A 73 year old clergy man was indebted to the bank ○ His only income came from a clergy stipend ○ Clergy man had an annuity and	○ In the absence of any such direct proof of intention, if a person owing debts makes a settlement which subtracts from the property which is the property fund for the payment of those debts, an amount without which the debts cannot be paid, then, since it is the necessary consequence of the settlement that some creditors must remain unpaid, it would be the duty of the Judge

transferred it to Mrs. Walpole	to direct the jury that they must infer the intent of the settlor to have been to defeat or delay his creditors, and that the case is within the statute

Ex Parte Mercer (1886) Eng CA

Facts	Holding
○ A ships captain was engaged to be married in England ○ Captain goes to the far east ○ Vyse brings an action in England for breach of promise to marry ○ Captain gets two messages: the court action and the inheritance of annuity (worth 500 pounds) ○ Vyse gets a judgment for 500 pounds – Vice moves to settle aside the settlement	○ In order to make the deed void we are bound to find that there was an actual intent in the bankrupt's mind to defeat or delay his creditors, and there is no evidence of such an intent

Mandryk v. Merko (1971) Man CA

Facts	Holding	Ratio
○ Some farm lots were transferred into Merko's wife's name	○ Was the transfer a debt or a claim on the date of the transfer? ○ The evidence of a subjective/honest intent will defeat the badges of fraud	○ The evidence of a subjective and honest intent will defeat the circumstantial badges of fraud

There seems to be a relatively light onus on the defendant in this case to come up with a credible explanation.

Role of Consideration

What is good and valuable consideration? Good and valuable consideration is something more than nominal consideration. Good and valuable consideration, however, need not be adequate consideration. In other words, the courts will not assess the relative worth of those things that are being transferred.

McKay v. Archibald – Past consideration is good consideration for the purposes of the *Fraudulent Conveyances Act* if it is more than nominal.

At the end of a trial it is going to be a defense if there was good consideration, the transferee was bona fides and had no knowledge of the transferor's intent. The onus is on the plaintiff to show that the transferee was *privy* to the fraudulent intent. Note: the word privy connotes some type of participation.

Solomon v. Solomon (1977) ON HC

Facts	Holding	Ratio
○ The plaintiff had a judgment for arrears – she had filed a writ of fifa with the sheriff ○ As part of the separation, Mrs. Solomon transferred here share of the matrimonial home for money – Mr. Solomon transferred the matrimonial home to Ms. Krawec who gave a mortgage back to Solomon for part of the purchase price ○ He also transferred his tools and an	○ There has been good and valuable consideration paid by Ms. Krawec ○ The burden of proving the necessary state of mind on the part of the defendant Krawec is on the plaintiff ○ Circumstances that are merely suspicious are not sufficient – circumstances must be examined to determine if there have been any 'badges of fraud'	○ The burden of proving the necessary state of mind is on the plaintiff – mere suspicious circumstances are not enough, the plaintiff must lead some badges of fraud from those circumstances ○ The transferee must be *privy* to the fraudulent intent

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old boat and continued to live in the house as a 'roomer' ○ The mortgage was paid off very quickly – upon transfer Ms. Krawec instructed her lawyer not to conduct a title search		

Under the *Assignments and Preferences Act* if the plaintiff can prove the 4(1) elements it appears as though the onus is on the defendant to find a safe haven under section 5 (payment of money, ordinary course of business, or present actual adequate consideration). Where good and valuable consideration is given, does the plaintiff have to prove the intent of the transferee under the *APA*? The jurisprudence indicates an affirmative response. Section 5 says 'adequate consideration' – what is the position under the *APA* where you have a transferee that has paid good and actual consideration, but not adequate consideration?

Leighton v. Muir (19??) NS

Facts	Holding
○ A transfer by a brother who had inherited the family home ○ The brother got into debt and left for the U.S. – just before he did he transferred the home to his sister ○ Creditors attack under APA and FCA	○ The judge concludes that good and valuable consideration has been given and, thus, it must be shown that the sister is privy to the fraud under the FCA ○ Where inadequate consideration is shown then there is no need to involve the intent of the transferee

You will always need the 'near' relationship before you can get into the adequacy of consideration aspect. Note: you must be a creditor at the date of the impugned transaction for the APA to apply

Ferguson v. Lastweka (1964) ON HC

Facts	Holding
○ Lastewka is in jail for drunk and careless driving ○ The lawyer has been given instructions transfer the house to Lastweka's son-in-law, Ewaschuk (Lastweka owed him money and the transfer along with another $2,000 wiped out the debt) ○ Lastewka remains living in the house with the Ewaschuk's, the explanation is that he is a father and elderly ○ An attack was made under the FCA	○ The case is set aside ○ After the alleged sale there was no change in this arrangement – joint possession raises a presumption of fraud ○ Where you have consideration given the strongest evidence is that which will show a sham transaction

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Unjust Preference

Statutory Regime

A preference is a payment or transfer to a creditor to pay or secure that creditor. The preference has the effect of benefiting that creditor more than the other creditors – the intent is to prefer. If you have a transfer and even if you can show that the intent of the transferor was to prefer the transferee, you cannot attack that under the *FCA*. The *FCA* requires the intent to defeat, delay, or hinder other creditors.

Section 4(2) of the *APA* calls for a transfer to a creditor while insolvent with intent to prefer and the effect is to prefer. In such a case, the defendant would need to seek protection under the safe-haven provisions of section 5.

Brocklesby v. Freedman-Ellis (1932) ON CA

Facts	Holding	Ratio
o Supplier decided to take back some inventory in order to reduce indebtedness – this would appear to hurt other creditors because it would reduce the size of the pie for the other creditors o This take-back was kept secret	o The plaintiff must prove that the creditor who was paid knew of the insolvency o The plaintiff must prove that the creditor intended to gain a preference o The plaintiff must show that payment was unjust	o Under the APA you must prove concurrent intent: 1. Creditor knew of insolvency; 2. Creditor intended to gain a preference; and, 3. Payment is unjust

The court has read a requirement of concurrent intent into subsection 4(2) of the *Assignments and Preferences Act*.

Subsection 4(3) provides that if an action is commenced within 60 days of the impugned transaction and you can show the effect of the transaction is adverse to your interest as a creditor, then you get a rebuttable presumption of the intent of the transferor. Subsection 4(3) only gives a presumption of the intent of the transferor (recall the requirement of concurrent intent between the transferor and transferee that the courts have read in).

The dynamics of the cases require the plaintiff to call evidence of intent. In many of the cases, you will find that there is some connection between the transferor and the transferee. In most cases the defendant will try to call evidence to try to show solvency at the time of the transfer or some other intent that shows the intent to prefer.

1. *Ordinary Course of Business* – this does not necessarily mean payment on the payment terms if the business historically has not paid on time. The court will look at how the particular business has conducted its affairs to determine whether any of the operations were out of step;
2. *Previous Promise* – when the money was lent or materials supplied security was demanded, but it is not given for some time. If you can prove the *bona fide* promise the intent will not be to prefer, but instead to fulfill the binding promise;
3. *To Stay in Business* – a particular creditor might be paid off because that creditor is threatening to cut-off business relations necessary for the life of the business.

Section 5 of the *APA* provides a safe-haven that is 'any payment of money to a creditor'. In Ontario, payment of money to a creditor cannot be attacked as a preference under the *APA*, but it might be attacked under the *Bankruptcy Act*. The third preference is 'present adequate consideration'. Note: If X pays a

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debt that is owed to Y, there is present adequate consideration (the discharge of the debt). Anytime you have a preference you always have present adequate consideration.

Any payment of money is not a preference!

Rather than making a conveyance to X in payment of a debt (property, shares, etc.,), take the inventory and sell it to somebody for present actual and adequate consideration and then take the money to support the payment of the debt. The only time this can successfully be attacked is where the purchaser of the inventory was in on the scheme.

Doctrine of Pressure

The doctrine of pressure is referred to in subsection 4(3) of the *APA* – 'whether it be made voluntarily or under pressure'. The idea was that this subsection's presumption was passed to give a presumption of intent. It is said that the attack of preference, the preference must be a voluntary act of the transferor.

If you have a creditor who is 'raising hell' to such an extent that the transferor becomes pressured, the transfer is involuntary, then you have a defence. The doctrine of pressure has very seldom been applied in recent history.

Royal Bank v. Sullivan (1957) ON HC

Facts	Holding
○ Sullivan owes the Royal Bank money and they are calling the loan ○ Sullivan transfers the business to his son ○ Sullivan mortgaged the real estate to Herr, but he owed Herr money	○ The transaction between Sullivan and Herr was a fraudulent scheme on the part of both parties to defeat the other creditors of Sullivan and made with the predominant intention on the one hand to vie and on the other hand to receive an unjust preference ○ This is either a preference or a fraudulent conveyance depending on which way you want to look at it – What looks like a preference could be a fraudulent conveyance because it is shammed ○ Alternatively we have a preference – a transaction taken with the intent to prefer

There are three attacks:
1. Fraudulent Conveyance under the *Fraudulent Conveyances Act*;
2. Fraudulent Conveyance under the *Assignments and Preferences Act*; and,
3. Preference under the *Assignments and Preferences Act*

Ethics of Judgment Proofing

When a client wants advice about judgment proofing, the role of the lawyer is to explain the law to them. The lawyer should tell the client about the *Fraudulent Conveyances Act*, *Assignments and Preferences Act*, and *Bankruptcy Act*. Is there anything wrong with explaining the law and jurisprudence to them? It is unlikely. It is only when you begin to advise a client to do something that you might run into problems – if you have examined the advice you are advising your client to commit fraud. Even worse, if you then transfer the property that you advised to be transferred you are participating in the fraudulent conveyance.

Chan v. Stanwood (2002) BC CA

Facts	Holding
○ Chans got a judgment against the Stanwoods for $264,000	○ The assets have been 'uglified' such that they would defeat creditors because of the fraud

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○ The Stanwoods lawyer, Davis, provided the Stanwoods with a paper he had written about family holding companies, which made assets available only to the company creator and unreachable from creditors	○ By reason of his conduct Davis was *privy* to the torts committed – he induced those torts to be committed

There is a conspiracy where you do something illegal, or something legal through an illegal means. When does judgment proofing become illegal?

R. v. Zlatic

Facts	Holding
○ Zlatic came up with a gambling scheme that would make him rich ○ Zlatic took nventory, sold it, took the money and went to the Casino	○ Selling and knowingly squandering the money is fraudulent

Bank of Nova Scotia v. Simpson

Facts
○ Father conveyed house to son at time of insolvency while the creditors were pressing ○ The son did not find out about the conveyance until 17 months after the transfer ○ The house was conveyed again to the wife of the lawyer

Petrone v. Jones

Facts	Holding
○ Lawyer advised that before going into business, the husband should transfer his assets to his wife	○ There is an onus on the defendant to disprove that the intent of the transfer was to defeat future creditors

Mareva Injunction

Prior to the mid 1970s courts would not give a pre-judgment creditor any remedy. The unsecured creditor could do nothing about a debtor who would move assets around and out of the jurisdiction except for very limited instances: where there is egregious fraud. However, short of an egregious fraud an injunction was not available.

In order to obtain a mareva injunction, the plaintiff must show:

1. Full and frank disclosure;
2. A strong prima facie case of whatever the cause of action is;
3. Identify assets within the jurisdiction of the court;
4. There is a risk of removal of those assets from the jurisdiction of the court; and,
5. An undertaking as to damages

The effect of a mareva injunction is to freeze the assets of the debtor. The injunction orders that the defendant shall not transfer any assets, move bank accounts, remove monies etc., Once the mareva injunction is served on the defendant s/he is frozen. The mareva injunction ought to be served with any institution or office relevant (financial institution or registry office). The mareva injunction only acts *in personem* and not *in rem* – a beneficiary has no property right in the assets.

The problem with mareva injunctions is in the fourth requirement – showing risk of removal. Consider that anytime you have a claimant who has yet to receive judgment, there is always a risk that the debtor will remove the assets. The creditor must show a *likelihood* or evidence to show the defendant is about to

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move assets or is the type of person that would move assets. You have to show that the defendant will move assets with the intent to defeat the plaintiff.

Oppression Remedy

The oppression remedy can be used as an unsecured creditor's remedy. The parts of the CBCA that are relevant to a creditor provide at section 241:

> (1) A complainant may apply to a court for an order under this section
> (2) If, on an application under subsection (1), the court is satisfied that in respect of a corporation or any of its affiliates
>   a. Any act or omission of the corporation or any of its affiliates effects a result,
>   b. The business or affairs of the corporation or any of its affiliates effects a result, carried on or conducted in a manner, or
>   c. The powers of the directors of the corporate or any of its affiliates are or have been exercised in a manner
>
> That is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer, the court may make an order to rectify the matters complained of.

The courts can recognize a creditor as a complainant. At the date of the impugned conduct the applicant can be a claimant or a creditor. Future creditors might also have standing. Having gained standing the applicant has to allege evidence that prima facie is evidence of oppressive conduct. Note, the oppression remedy requires oppressive or prejudicial conduct, thus non-payment of wages upon bankruptcy will not be considered oppressive. The question to ask:

1. What is the creditor's reasonable expectation? (refer to page 119)

You only have to prove that the effect of the oppressive conduct was to defeat the creditors – there is no requirement to prove intent to defeat.

It is open to the court to craft the remedies for oppression. The usual remedies include personal judgment against the oppressing officers. Any third party that benefited must disgorge what they received.

CC Petroleum v. Allan (2002) ON SCJ

Facts	Holding
o Two brothers and a father ran a pay right through a corporation o There was no revolving line of credit, just the use of three banks and a movement of money o Allan's ran cheque-kiting scheme o The Allan's closed shop once the money got tight o The wives held debentures in the company and sent in receivers o A chartered accounting firm hired one of the brother to act as receiver o The cheques payable to CC were not honored, but the wives were able to cash in on the debentures	o It is alleged that the defendant's suppressed the fact that the pay right was insolvent; payments made to the wives and Allan brothers were preferred; the Allan's kept purchasing petroleum with the intent not to repay, but instead to pay themselves; pay right was used to appoint a brother as receiver; a mortgage was given on one of the owned houses to a cousin o The defendant's conduct was oppressive o It was a reasonable expectation of the creditor's that this corporation would not continue to carry on business while it was insolvent, thereby rendering the pay right unable to pay its creditors

When directors or officers are aware that a corporation is insolvent, it may be oppressive to continue ordering supplies and inventory from a creditor.

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Derivative Action

The derivative action involves the creditors attempting to show that the directors breached their fiduciary duty *to the corporation*. A third party with standing is attempting to lead the action on behalf of the corporation. One of the advantages of the derivative action is that it would be available to future creditors.

Duty of Care

Section 122 of the CBCA provides:

> Every director and officer of a corporation in exercising his powers and discharging his duties shall
> (a) act honestly and in good faith with a view to the best interests of the corporation, and
> (b) exercise the care, diligence and skill that a reasonable prudent person would exercise in comparable circumstances

This provision places a relatively low standard on the directors. To whom does a director owe the duty of care? The director owes the duty to the corporation. The director does not owe the creditors of a corporation the duty of care. However, where you have an insolvent corporation the creditors are to be paid first. The stakeholders are the creditors in an insolvent corporation and, therefore, the director owes a duty to the corporation, which includes looking to the interests of the creditors, when it is insolvent.

People's Department Store Inc. v. Wise (1988) QB SC

Facts	Holding
o The Wise brothers ran the department store and entered into a new inventory policy o All the inventory was purchased by People's – People's would transfer some of the inventory to the Wise stores o Wise owed People's, but only People's was on the hook to suppliers	o The evidence as established shows that in instituting such an inventory policy and failing to monitor the debt, the Wise brothers failed to exercise the care, reason, and skill expected of a reasonable person is similar circumstances o The Wise brothers derived no direct benefit from the inventory policy o There was no dishonesty or fraud on the part of the Wise brothers

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Bankruptcy

Bankrupt is a status – you either are or you are not. Insolvency and bankruptcy are two totally different things. There are two ways methods to get into bankruptcy: (1) voluntary and (2) involuntary.

Involuntary Bankruptcy

In order to make a corporation bankrupt, but it does not wish to become so, you clearly require some judicial process whereby the petitioner will have to prove certain things that make it just and/or convenient to put that corporation into a state of bankruptcy. A corporation cannot come out of bankruptcy unless it pays off all of its creditors (section 164 *Bankruptcy Act*). A bankrupt corporation is able to make a proposal to its creditors to arrange long-term repayment or a reduced debt. Short of such an agreement, however, the corporation will not come out of bankruptcy.

Section 43 of the *Bankruptcy Act* provides that a petition may be filed for a receiving order – bankruptcy only occurs after a receiving order is given. Section 43(1) of the *Bankruptcy Act* provides:

> (1) Subject to this section, on or more creditors may file in court a petition for a receiving order against a debtor if, and if it is alleged in the petition that,
> (a) the debt or debts owing to the petitioning creditor or creditors amount to one thousand dollars; and
> (b) the debtor has committed an act of bankruptcy within six months next preceding the filing of the petition
>
> …
>
> (14) A petition shall not be withdrawn without the leave of the court

Review the entirety of section 43. Section 45 provides:

> Where a receiving order is made, the costs of the petitioner shall be taxed and payable out of the estate, unless the court otherwise orders.

Acts of Bankruptcy – 43(1)(b) and 42

It usually is not a problem to prove a debt of more than one thousand dollars. Section 42(1) provides the acts of bankruptcy:

> A debtor commits an act of bankruptcy in each of the following cases: (a) – (j)

Note: proof of insolvency is not part of the requirement to put a corporation into bankruptcy. You just have to prove that you are owed money plus one of the acts of bankruptcy. These acts are really just badges of insolvency – the sort of thing that the typical insolvent corporation does. The most commonly used ones are 42(1)(e) and (j).

The real problem is whether a single unpaid creditor can use paragraph 42(1)(j). If the single creditor cannot use (j) s/he must file an action, get judgment, receive a writ of execution, and use paragraph 42(1)(e), but in the mean time the assets may be moved around. The single creditor can use paragraph 42(1)(j), but there must be a very good reason for its application:

1. Where there appears to be repeated demands;
2. A significant creditor and a suspicion of fraud; or,
3. An admission of the inability to pay

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At subsection 43(7) the statute provides discretion to dismiss a petition:

> Where the court is no satisfied with the proof of the facts alleged in the petition or of the service of the petition, or is satisfied by the debtor that he is able to pay his debts, or that for other sufficient cause no order ought to be made, it shall dismiss the petition

One of the problems that has come up from time to time is where the debtor is able to prove that s/he is able to pay debts as they come due and the creditor questions why his/her debts are not being paid. Note that the provision does not require willing and able – just able. There is jurisprudence in *Re McGuire*, which provides that a debtor who can pay his/her debts will have ordered a receiving order, but it will be stayed for seven days. If the debt is not paid within seven days the receiving order will be enforced.

The court has a residual discretion not to grant where it is satisfied that the creditor is using the petition for an improper collateral purpose

Re De La Hooke

Facts	Holding
○ A debt was purchased ○ The creditor wanted to force the debtor into bankruptcy so that s/he could get trade-mark rights	○ A petition can be denied if the interest is collateral and illegitimate to the bankruptcy

Re Pappy's Good Eats (1985) ON SC

Facts	Holding
○ Chungs financed the petition ○ Chungs were in litigation with the bankrupt company	○ Court detecting the collateral purpose dismissed the petition

Re Harrop of Milton Inc. (1979) ON SC

Facts	Holding
○ We have a secured creditor and a landlord, Novak ○ Novak distrains for arrears of rent, which is the right of a landlord to sell the personal property of the tenant and apply it against the arrears of rent ○ As between the landlord distraining and the secured party, who wins?	○ Under the PPSA, outside of bankruptcy the landlord wins ○ The landlords rights of distraint will beat a secured interest outside of bankruptcy ○ If bankruptcy takes place, section 136 of the *Bankruptcy Act* provides that the landlord is given a preference for 3 months arrears and 3 months accelerated rent ○ In bankruptcy, the secured party prevails ○ *Issue:* Is the threat of a landlord using his/her right of destraint a good reason for using the petition? ○ This is not an illegitimate reason

Voluntary Bankruptcy

Section 49 of the *Bankruptcy Act* provides that if the debtor signs a voluntary assignment of bankruptcy then the company/corporation will go into bankruptcy. When the receiving order is made pursuant to the assignment, the trustee is appointed.

Re Public's Own Market (1984) BC SC

Facts	Holding
○ A corporation owed a lot of money to a finance company	○ This is a legitimate

○ The directors of the corporation guaranteed the loan ○ Rent goes into arrears and the landlord distrains ○ It is in the best interest of the corporation to volunteer into bankruptcy because then the assets will go to the bank – avoid the personal guaranty	assignment of bankruptcy

Consequences of Bankruptcy

An insolvent debtor can make a proposal to its creditors in order to 'work out' the differences. Under the *Act* filing a proposal will trigger a stay of proceedings. If the proposal is voted down the bankruptcy occurs. If the proposal is accepted and it is later broken, the court will order a bankruptcy retroactive back to the filing of the proposal. It became clear a number of years ago that in order to facilitate successful proposals you need a mechanism where the debtor can talk to the creditor about making a proposal with the creditor panicking and cutting off the debtor. The result was the creation of the notice of proposal, which would trigger a stay of proceedings for 30 days.

Section 69.3(1) of the *Bankruptcy Act* provides:

> Subject to subsection 2, on the bankruptcy of any debtor no creditor has any remedy against the debtor or the debtor's property or shall commence or continue any action, execution or other proceedings, for the recovery of a claim provable in bankruptcy, until the trustee has been discharged

The time of bankruptcy is determined by section 2 of the *Act*:

> For the purposes of this Act, the bankruptcy or putting into bankruptcy of a person occurs at the time or date of
> (a) The granting of a receiving order against the person;
> (b) The filing of an assignment by or in respect of the person; or,
> (c) The event that causes an assignment by the person to be deemed

What if the individual contravenes the stay of proceedings? The courts have held that what is done contrary to the stay is not void, but rather an irregularity – the court can validate the irregularity if it is appropriate to do so.

Priorities

What is the priority between executing creditors and the trustee in bankruptcy? Section 70(1) provides:

> Every receiving order and every assignment made in pursuance of this Act takes precedence over all judicial or other attachments, garnishments, certificates having the effect of judgments, judgments, certificates of judgment, judgments operating as hypothecs, executions or other process against the property of a bankrupt, except those that have been completely executed by payment to the creditor or his agent, and except the rights of a secured creditor

In Re Christian (1957) ON SC

Facts	Holding
○ Sheriff had executed ○ 30 days had passed and the sheriff is about to send the money to the creditors	○ The execution is not completed until the money reaches the creditors – the sheriff is not the agent of the creditor, but a trustee of the Crown

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Canadian Credit v. Beaver Trucking (1959) SCC

Facts	Holding
o Garnishment before judgment and then bankruptcy occurs o Who gets the money? The garnishing creditor or the trustee in bankruptcy?	o The trustee takes priority o The service of a garnishing order creates an equitable charge upon the debt in favor of the garnishing creditor and, if such a charges falls within the definition of a secured creditor in the *Bankruptcy Act*, it must be that they are not included in the expression 'the rights of the secured creditor"

Landlords

A landlord distraining is not an execution creditor, he is doing it pursuant to some statutory right. Section 73(4) provides:

> An property of a bankrupt under seizure for rent or taxes shall on production of a copy of the receiving order or the assignment certified by the trustee as a true copy thereof b delivered forthwith to the trustee, but the costs of distress are a first charge thereon, and, if the property or any part thereof has been sold, the money realized therefrom less the costs of distress and sale shall be paid to the trustee

The landlord is going to lose to the trustee in bankruptcy unless the distraint is filed on the date of bankruptcy.

Re Shouthern Fried Foods (1976) ON SC

Facts	Holding
o We have a sale under the Landlord and Tenants Act o The bailiff sold the goods and the bailiff got the money for the goods – he gave a cheque to the landlord, but it did not clear the bailiff's bank account at the date of bankruptcy	o The bailiff had the money – he is the agent of the landlord and, therefore, the execution had been completed

Claims Provable in Bankruptcy

The trustee will speak to the bankrupt and get a list of creditors. The trustee will send out to the claimants a proof of claim form. The proof of claim form asks the creditor a number of questions:

1. What are the particulars of the claim?
2. Are you claiming any priority as per section 136 of the *Bankruptcy Act*?
3. Details of security interests;
4. Does corporation, blood, or marriage relate you to the debtor?
5. Have you received any payments or transfers in the last 3-12 months?

This form is filed with the trustee of bankruptcy at the first meeting of the creditors. What about unliquidated claims – such as a claim for breach of contract? You would claim damages in an amount that you think you would be awarded suing for breach of contract in court.

Section 135 of the Act provides a summary procedure for valuation. The alternative method is to lift the stay of proceedings so that the individual can go on with the action to prove the quantum of damages.

What about executory contracts? Upon bankruptcy the creditor can cancel the contract. Upon cancellation that is the date of damages assessment. However, bankruptcy in itself does not cancel the

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contract – it provides the right to cancel the contract by the creditor. If the contract is not cancelled the trustee can acquire that contract.

The most common executory contracts in this context are real estate leases. If the landlord can rent it out at a better rent, the landlord is going to be very keen to end the contract. However, if the rent is good and the trustee believes it could sell the lease and get some money in the estate, the trustee is going to want to confirm that. There are special methods of handling:

1. Under section 136(f) of the *Act*, the landlord is given priority for arrears of rent (3 months arrears and 3 months accelerated rent) and any occupation rent while the trustee is in there;
2. Under section 146 of the *Act*, provides that except for 136(f) the provincial laws of landlords are intended to apply;
    a. Section 38 and 39 of the *Commercial Tenancies Act* provide: 38(2) – the trustee can retain the lease or any part of it and pay rent or even assign the lease, the trustee has 3 months to decide whether s/he will do this or not; 39(2) – a sub-leasee can keep a lease, but must continue to pay at the sub-lease rent

Unsecured creditors have to file a proof of claim – this is a matter of saying how much of the claim is owed to the particular creditor. What happens when you have an executory contract? Bankruptcy itself will not rescind the contract unless the contract expressly provides for it. The most common executory contract in a bankruptcy is usually a lease – landlords are treated specifically under the *Act* at section 136 and are entitled to three months rent preference and three months interest preference. The trustee in bankruptcy is given a three-month window upon which to affirm the lease.

Secured Creditors

The stay of proceedings provision at section 69(2) does not apply to the secured creditor. However, the court can delay a secured creditor for a period not exceeding six months. Unless the trustee can show that three is some purpose in obtaining the delay the court will not grant it.

What is to stop a secured party from not co-operating with the bankruptcy at all? Why would the secured party file a proof of claim at all? Sections 127 through 135 of the *Act* contain provisions for the relationship between the trustee and the secured party:

Section 79 – gives the trustee a right to inspect the collateral
Section 127 – the secured party can file a proof of claim
Section 128 – allows the trustee to force the secured party to file a proof of claim otherwise the trustee can hold the asset free and clear of the security interest
Section 128(3) – gives the trustee the right to redeem
Section 129 – the trustee can force a commercially reasonable sale of the asset
Section 130 – the secured party can force the trustee to declare whether it will redeem or force a sale
Section 131 – procedures for amending the valuation of the collateral
Section 132

Problems arose prior to 1992 whereby trustees felt that they were not getting sufficient opportunity to get information and control over secured parties. Thus, in 1992 Part 11 of the Act was passed, embodied in section 244, providing that if a secured party is going to send in a receiver then you must give the insolvent person 10 days notice.

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Property of the Estate

Property in section 2 is defined very broadly. Section 71(2) of the *Act* provides:

> On a receiving order being made or an assignment being filed with an official receiver, a bankrupt ceases to have any capacity to dispose of or otherwise deal with his property, which shall, subject to this Act and to the rights of secured creditors, forthwith pass to and vest in the trustee named in the receiving order or assignment

In other words when bankruptcy occurs the bankrupt has not property – it all belongs to the trustee in bankruptcy. Section 67(1) modifies this provision:

> The property of a bankrupt divisible among his creditors shall not comprise:
>
> (a) property held by the bankrupt in trust for any other person;
>
> (b) any property that as against the bankrupt is exempt from execution or seizure under any laws applicable under any laws applicable in the province within which the property is situated and within which the bankrupt resides; or,
>
> (b.1)such goods and services tax credit payments and prescribed payments relating to the essential needs of an individual as are made in prescribed circumstances and are not property referred to in paragraph (a) or (b),
>
> but is shall comprise
>
> (c) all property wherever situated of the bankrupt at the date of his bankruptcy or that may be acquired by or devolve on him before his discharge, and
>
> (d) such powers in or over or in respect of the property as might have been exercised by the bankrupt for his own benefit

Section 67(2) provides:

> Subject to subsection (3), notwithstanding any provision in federal or provincial legislation, that has the effect of deeming property to be held in trust for Her Majesty, property of a bankrupt shall not be regarded as held in trust for Her Majesty for the purpose of paragraph (1)(a) unless it would be so regarded in the absence of that statutory provision

In 1992 the federal government held that deemed trusts do not work. However, under section 97(3) the federal makes these deemed trusts effective for income tax, Canadian pension, and employment insurance and any other similar provincial legislation that is similar to these programs. There were still large problems relating to whether the court would recognize these deemed trusts as effective – the courts were reluctant to do it. The court struck down a lot of the legislation and the federal government is currently amending a great deal of the legislation to make it clear that the federal government will get priority – over both the trustee in bankruptcy and secured parties. Even under true equipment leases the federal government is claiming priority over the lessor for unpaid taxes.

Section 17 of the *Act* provides a duty to deliver property to the trustee in bankruptcy. Be aware of section 68, which deals with after-acquired property of individuals who become bankrupt.

Section 73 provides that a sheriff and/or landlord must deliver property

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Section 74 points out how we take the bankruptcy and plug it into the land registry – immediately register the receiving order against title otherwise a bona fide purchaser for value without notice will take free and clear
Section 76 – it is illegal to remove property from the province

Rights of Set-Off

Section 97(3) – if an individual goes bankrupt and another owes her $10,000 the trustee in bankruptcy will ask that the $10,000 be paid to him. What if at the date of bankruptcy the bankrupt owed $5,000? Could that $5,000 owed be set-off against the other $10,000 owed? You can if the law of set-off allows it.

Coopers & Lybrand v. Lumberland (1983)

Facts	Holding
o The bankrupt supplied goods to the third party o The third party owed money for the price of the goods o The third party goes bankrupt o The third party submits that according to the contract s/he would get a rebate at the end of the year based on the volume of the goods sold o The third party wants a set-off	o *Issue*: Is that rebate the type of claim that can be set off against the debt under the laws of the particular province? o There are two types of set-off, legal and equitable o A legal set-off must exist at the time of bankruptcy o The rebate became a debt at the time the goods were sold o An equitable set-off is one where you might have a claim for breach of contract (recall a breach of contract is not liquidated and when unliquidated cannot be a debt) – the claim has to be associated with or arising from the same transaction that you owe the bankrupt money for

The law of set-off applies to claims where the trustee is gathering property. There are a number of types of set-off, the most common being legal and equitable.

Section 81.1 of the *Act* provides the right of the unpaid supplier to repossess goods. This section was put in to try to give a remedy to unsecured creditors who had supplied goods to the bankrupt entity. If a supplier delivers goods and if that seller demands repossession of the goods by serving a demand for repossession on the purchaser or the trustee (in the event of bankruptcy) or the receiver (if a secured party has gone in) within 30 days of delivery and if at the time of service the goods are identifiable and have not been re-sold, then the supplier has 10 days to re-take possession. This right beats *any* other claim including a secured party under the *PPSA*.

Review of Pre-Bankruptcy Proceedings

The date of bankruptcy is the date of the receiving order or the date of the filing of the assignment. In section 2 the legislators came up with a 'date of initial bankruptcy event':

> "date if the initial bankruptcy event' in respect of a person, means the earliest of the date of filing of or making of
> (a) An assignment by or in respect of the person
> (b) A proposal by or in respect of the person
> (c) A notice of intention by the person
> (d) The first petition for a receiving order against the person

The sections of the Act that are going to relate are 91, 92, 93, 95, 96, 98, 100, and 101

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Section 99 reads as follows:

> All transactions by a bankrupt dealing with any person dealing with him in good faith and for value in respect of property acquired by the bankrupt after bankruptcy, if completed before any intervention by the trustee, are valid against the trustee, and any estate or interest in the property that by virtue of this Act is vested in the trustee shall determine and pass in such manner and to such extent as may be required for giving effect to any such transaction

Preferences

Section 95 of the *Act* provides:

> Every conveyance or transfer of property or charge … is where it is made, incurred, taken or suffered within the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date the insolvent person became bankrupt, both dates included, deemed fraudulent and void as against the trustee in the bankruptcy

Section 95(2) provides a shifting onus – the effect of the payment must be proven to have preferred. Where the effect of the payment is to prefer there is a shift in onus. The onus, when shifted, is on the creditor to prove the intent was not to prefer. You do not have to prove concurrent intent – it is only the intent of the transferor.

What about preferences to a secured party? Is it possible if a debtor, within three months prior to the initial bankruptcy event, makes a payment to a secured agreement to attack the secured creditor? If a security interest is given within three months, that clearly can be a preference. We are talking about a return of goods to a secured party.

Re Gilbert

Facts	Holding
○ Not Done	○ Neither party to the agreement had the agreement in mind when the merchandise was returned, the conditional vendor did not seize or appropriate the goods as per the agreement, but rather they were returned, without demand by the secured party or default, to the secured party ○ Regardless of what was in the minds of the two at the time of the return, title to the merchandise never passed to the debtor so while the creditor received a preference he never received a fraudulent preference ○ **This case is wrong** – in a conditional sales contract the buyer is the beneficial owner subject to a security interest

What if we have a return of goods just prior to bankruptcy when the security interest is unperfected? Stewart thinks that you would have to move to the oppression remedy.

Another element of the preference is that you have to prove insolvency at the date of the impugned transaction. Section 2 of the *Act* defines insolvency. Then you have to prove the intention to prefer – this is where subsection 95(2) comes in. Ask: has the defendant proven on a balance of probabilities that the intention was not to prefer. The trustee does not have to prove concurrent intent in the *Bankruptcy Act* – the shift provides the defendant to show some other form of intention:

1. Ordinary course of business;
2. Continuing in business – the move must be reasonable (objective test);
3. Prior promise to give security;
4. Diligent creditors

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Settlements

Section 91 provides that any settlement of property occurring within one year of the bankruptcy is void as against the trustee. Subsection 91(2) provides that any settlement occurring within five years of the bankruptcy is void against the trustee if, but only if, the trustee can prove the settler was at the time of making the settlement unable to pay all of his debts without the aid of the settled property. Thus, any settlement within one year of the initial bankruptcy event is set aside. Any settlement made within five year may be set aside if the bankrupt is unable to pay debts without the debt of the settled property.

This section does not extend to any settlement made before or in consideration of marriage.

The section does not apply in favor of a purchaser or encumbrancer in good faith and for valuable consideration – thus, if you find that valuable consideration has been given, you do not apply this section.

What is a settlement? When you break it down the *Act* is attacking gifts – if the settlor made a gift within a year of bankruptcy and the creditors are being stiffed, it is only fair that the gift should be void. However, while this seems to be reasonably fair, but look at the dynamics of it: the bankrupt has to give back Christmas and birthday presents? No, it is not any gift that we are aiming at – it is a settlement gift.

Invariably, the most common settlement is a gift in contemplation of staying in a traceable form.

Ram Gautrea? (SCC)

Facts	Holding
o 13 months before bankruptcy, the doctor transferred an RRSP into an insurance contract with his wife named as beneficiary o Trustee wants to attack	o The effect of the transaction is that under provincial law the insurance contract is not realizable by judgment – immune from creditor attack o Section 91 is ineffective because it has been more than one year o *Issue*: Is this a settlement? o There are two transfers: (1) a transfer from non-exempt to exempt status; and (2) the naming of his wife as a beneficiary o The transfer to the insurance contract is not a settlement – it is not a settlement unless it is to some third party o The naming of his wife is a settlement because it is a transfer of some interest to a third party o If it had been done within one year, the designation would be a settlement and automatically void (set aside as per 91) o This is a contingent transfer – contingent on death and the settlor's interest did not pass and, therefore, could be attacked within the five years o Although this is void under section 91 and although the interest vests back in the trustee, under section 67 this is not available to creditors because provincial legislation says it is exempt

Is this a method of escaping section 91? Gonthier held that if you can attack this transfer under provincial legislation, then it will be set aside. The door is left open to attack this as a fraudulent conveyance under either the *Fraudulent Conveyances Act* or the *Assignments and Preferences Act*.

Reviewable Transactions

Section 100 provides that where a bankrupt transacts or supplies property or services in a reviewable transaction within the period beginning one-year, the court may enquire whether the bankrupt gave or received fair consideration. Where the court finds the consideration was conspicuously greater or less, the court may give judgment against the other party to the transaction and against any other person being

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privy to the transaction. This is a way of getting at people who have not given a preference or settlement. The question turns on whether the person is at arm's length.

If you come within section 4 you are deemed not be operating within arm's length. This deeming is an irrefutable deeming. If you have a husband and wife, son or sister is going to trigger this analysis. Under 4(b) individuals connected by blood relationship, marriage or adoption are included.

The compass is set at one year before the eve of insolvency. The question becomes, what is meant by conspicuous? Conspicious is dependent upon the facts. For instance, a $50,000 difference in a contract where the fair market value is $100,000, that is conspicuously greater or less. However, $50,000 on $1,000,000 may be negligible.

How much discretion does the court have?

Payment of Dividends

Section 101 of the Act speaks to payment of dividends. If a payment of dividend occurs at a time of insolvency it is done at the expense of the creditors. Section 101 has a number of provisions that make proof easier. If there is a payment while the corporation is insolvent or if the payment made the corporation insolvent, the directors are personally liable jointly and severally whether they got the money or not, unless they can prove the corporation was solvent or unless they can show they relied on a qualified official who maintained the corporation was solvent.

The shareholders who got the payment did not participate, but they did get the dividend. The court can give judgment against the shareholders, but only those that were related to the directors.

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