SUMMARY OF CURRENT DOCUMENT	
Name of Issuing Party or Person:	**Hall, J.**
Date of Document:	**2003 04 04**
Summary of Order/Relief Sought or statement of purpose in filing:	**Filing of Decision on:** **1. Appeal by Canadian Imperial Bank of Commerce ("CIBC") of Final Determination of PricewaterhouseCoopers Inc. ("PWC") as Trustee ("Trustee") of Hickman Equipment (1985) Limited ("Hickman Equipment") seeking reversal of Final Determination as follows:** **(a) That CIBC be found to have a valid secured claim under a General Security Agreement;** **(b) That CIBC be found to have a valid secured claim under s. 427 of the Bank Act Security; and** **(c) That CIBC's interest in the assets of Hickman Equipment be found not to be subordinate to the interests of the holders of Permitted Encumbrances including *inter alia* Unperfected Purchase Money Security Interests ("Unperfected PMSI") holders, unless and only to the extent that CIBC has voluntarily subordinated same;** **AND:** **2. Appeal by John Deere Limited ("JDL") and John Deere Credit Inc. ("JDCI") of the Final Determination of PWC with respect to the security of CIBC and in particular the Determination made by the Trustee in favour of CIBC which is not appealed by CIBC to the effect that the transition under the Personal Property Security Act of a Demand Debenture is effective in respect of four Supplemental Debentures related thereto.**
Court Sub-File Number:	**9:06 (re applications 7:28(a) for CIBC**

SUMMARY OF CURRENT DOCUMENT	
Name of Issuing Party or Person:	**Hall, J.**
	and 7:36 for JDL, JDCI)

CITATION: Hickman, Re CIBC & Deere 2003NLSCTD46
DATE: 2003 04 04
DOCKET: 2002 01 T 0352

IN THE SUPREME COURT OF NEWFOUNDLAND AND LABRADOR
TRIAL DIVISION

IN THE MATTER OF the Court Appointed Receivership of Hickman Equipment (1985) Limited

AND IN THE MATTER OF the Bankruptcy under the Insolvency Act

AND IN THE MATTER OF the Application of Canadian Imperial Bank of Commerce and the Application of John Deere Limited and John Deere Credit Inc.

Heard March 3, 4, 6, 7 and 10, 2003

DECISION OF HALL, J.

Background

[1] By a Receiving Order made on the 13th of March, 2002, pursuant to the provisions of the **Bankruptcy and Insolvency Act ("BIA")** and filed with the Supreme Court of Newfoundland and Labrador in Bankruptcy on the 14th of March, 2002, Hickman Equipment (1985) Limited ("Hickman Equipment") was adjudged bankrupt and PricewaterhouseCoopers Inc. ("PWC") was appointed Trustee of the bankrupt estate (the "Trustee"). By a further Order of the Court granted on the 13th of March, 2002, and filed with the Court on the 14th of March, 2002, it was ordered that PWC be appointed Receiver ("Receiver") of Hickman Equipment (the "Receivership Order"). The Receivership Order gave PWC the overall mandate of developing a plan and procedural structure for the liquidation of the assets of Hickman Equipment, as defined in par. 6 of the Receivership Order, and also a plan for the determination of the rights of all creditors and claimants. In that regard, a Claims Plan was approved by this Court by an Order dated May 14,

2002, and filed May 17, 2002 (the "Claims Plan"). Paragraph 14 of the Claims Plan required the Trustee to issue a Final Determination either allowing a claim as a valid secured claim under s. 135(4) of the **BIA**, or disallowing it as a valid secured claim. Paragraph 15 of the Claims Plan provided that claims disallowed by the Trustee under this process were afforded a 30-day right of appeal under the **BIA**. The Trustee was not required under the Claims Plan to make findings as to the priorities between the security interests in the assets of Hickman Equipment as claimed by competing secured creditors.

[2] On December 3, 2002, the Trustee issued a Final Determination wherein it allowed the claim of CIBC in part (the "CIBC Final Determination"). In the CIBC Final Determination, the Trustee disallowed CIBC's claim to have an enforceable General Security Agreement dated January 25, 2002 (the "GSA") and further disallowed that CIBC had enforceable security under the **Bank Act** dated October 18, 2000 (the "**Bank Act** Security"). Further, in the Final Determination, the Trustee allowed CIBC's secured claim under a Floating Charge Debenture dated January 7, 1985 (the "Debenture") and Supplemental Debentures (collectively the "Supplemental Debentures") dated February 19, 1990; April 17, 1997; August 6, 1997 and July 9, 1998. However, the Trustee held that the CIBC security interest in the assets covered by the Debenture and the Supplemental Debentures, was subordinated to the interests of the holders of "Permitted Encumbrances" including, *inter alia*, Unperfected Purchase Money Security Interests ("Unperfected PMSI") holders. The Trustee further determined that the assets in which "Permitted Encumbrancers" have a security interest are held in trust by CIBC for the Permitted Encumbrancers.

[3] Additionally, in the Final Determination, the Trustee further determined that if CIBC did have a valid secured claim under the GSA, CIBC's security interest in the assets covered by the GSA was subordinated to the interest of holders of Permitted Encumbrances including, *inter alia*, Unperfected PMSI holders. The Trustee further determined that the assets in which the Permitted Encumbrancers have a security interest are held in trust by CIBC for the Permitted Encumbrancers.

[4] CIBC appealed portions of the Final Determination in accordance with par. 15 of the Claims Plan and s. 135(4) of the **BIA** as follows:

(a) That the Trustee erred in fact and law in determining that CIBC did not have a valid secured claim under the GSA;

(b) that the Trustee erred in fact and law in determining that CIBC did not have a valid secured claim under the Bank Act Security;

(c) that the Trustee erred in fact and law in determining that the scope of the CIBC Security under the Debenture and Supplemental Debentures and, if found to be valid, the GSA, was subordinated to the interests of the holders of Permitted Encumbrances including, *inter alia*, Unperfected PMSI holders and in determining that the assets in which Permitted Encumbrancers had a security interest are held in trust by CIBC for the Permitted Encumbrancers.

[5] John Deere Limited ("JDL") and John Deere Credit Inc. ("JDCI") (collectively "Deere") are also secured creditors of Hickman Equipment and have objected to the determination made by the Trustee in favor of CIBC, which is not appealed by CIBC, namely the determination that the purported transition of the Debenture and the Supplemental Debentures under the **Personal Property Security Act** ("**PPSA**") at Registration No. 1403243 on November 24, 2001 is effective in respect of the Supplemental Debentures. The basis of the objection is that the Debenture and the Supplemental Debentures were registered in the Registry of Deeds for Newfoundland and Labrador prior to the **PPSA** coming into effect on December 13, 1999, but when CIBC, by Registration No. 1403243 on November 24, 2001, claimed to have transitioned the Debenture and the Supplemental Debentures under the **PPSA**, CIBC had actually failed to include the Registry of Deeds registration particulars of the Supplemental Debentures in its Registration No. 1403243 under the **PPSA**. Deere claims that by this omission, a searcher using the **PPSA** Registry would not discover the pre-**PPSA** security claimed under the Supplemental Debentures, because all that was referenced in the transitional Registration No. 1403243 in the **PPSA** Registry was the roll and frame number for the Original Debenture. Deere, therefore, seeks to have the Court order that the Supplemental Debentures were not properly transitioned under the **PPSA** and are, therefore, ineffective and unenforceable under the **PPSA** (the "transition issue").

Uncontested CIBC Security

[6] CIBC claimed to be owed $15,433,523.95 (the "total debt") by Hickman Equipment, as at the date of bankruptcy, as set out in its Proof of Claim. The Trustee allowed the amount of $15,269,395 (the "total debt allowed"). CIBC claimed a security interest in assets of Hickman Equipment, based upon a General Assignment of Book Debts (the "GABD") dated January 4, 1985. The Trustee had allowed this claim under the GABD in the Final Determination and no creditor has appealed or contested that portion of the Final Determination. In an earlier judgment of the Court I have allowed the recovery by CIBC of Book Debts, Accounts, etc., pursuant to the GABD. The exact details of the Books Debts and Accounts allowed to be recovered is not relevant for the purpose of this particular judgment.

[7] In addition, as previously mentioned, the Trustee allowed the Debenture held by CIBC. The Debenture was limited to the principal amount of $3,000,000. It had subsequently been increased by the Supplemental Debentures to the maximum principal amount of $20,000,000. However, as previously mentioned, the transitioning of the Supplemental Debentures under the **PPSA** was contested by Deere, as well as other creditors who appeared on the application and presented argument thereon. Therefore, in the said earlier judgment, I authorized payment by the Trustee to CIBC of $3,000,000 in proceeds from the sale of assets of Hickman Equipment, secured by the Debenture, and over which no other creditor had made a claim.

Issues to be Decided

[8] The judgment in these matters will be confined to deciding the three issues of the appeal the CIBC set out in par. [4] except for the second portion of par. (c). It has been urged upon me, and I

agree, that any decision as to whether or not the assets in which the Permitted Encumbrancers had a security interest were held in trust by CIBC for the Permitted Encumbrancers requires an evidential hearing or hearings where the factual background of the alleged Permitted Encumbrances is explored. An opportunity to do this will arise in the individual applications by secured creditors claiming security interest in such assets. Additionally this judgment will deal with the transition issue set out in par. [5] hereof contained in the appeal of Deere against the Final Determination of the Trustee with respect to the claims of CIBC.

Transition Under PPSA of Supplemental Debentures

[9] I propose to deal with this issue as raised by Deere firstly before proceeding with consideration of the three grounds of appeal of the Trustee's Final Determination as set out by CIBC, more particularly contained in par. [4] hereof.

[10] Section 75 of the **PPSA** dealing with transitional perfection of prior security interests provides:

> 75. (1) Except as otherwise provided in this section, a prior security interest that on the commencement of this Act is covered by an unexpired registration under prior registration law is considered to have been registered and perfected under this Act as of the time of registration under prior registration law.
>
> (2) Subject to this Act, the registered and perfected status of a prior security interest referred to in subsection (1), other than a prior security interest referred to in subsection (3), continues only for the unexpired portion of the registration period but may be further continued by registration in accordance with this Act if the prior security interest could have been perfected by registration under this Act had the security interest attached after the commencement of this Act.
>
> (3) The registered and perfected status of a prior security interest that, on the commencement of this Act, is covered by an unexpired registration under the prior registration law continues only for 2 years after the commencement of this Act but may be further continued by registration in accordance with this Act if the prior security interest could have been perfected by registration under this Act had the security interest attached after the commencement of this Act.
>
> (4) A prior security interest is covered by an unexpired registration under prior registration law within the meaning of subsections (1) to (3) only if the requirements of prior registration law were complied with and regardless of whether or not the requirements for perfection of the security interest under this Act would have been met had the registration been made under this Act.
>
> . . .

(14) Where the perfection of a prior security interest that is considered registered or perfected under this section is continued by registration under this Act,

(a) . . .

(b) the registration supersedes a registration or perfection under prior law.
[Emphasis added.]

[11] Regulation 26 of the **Personal Property Security Regulations** enacted under the **PPSA** deals with the mechanics of the continuation of prior registration law security interests. It provides:

26. (1) Where a registrant wishes to continue the registered and perfected or perfected status of a prior security interest referred to in section 75 of the Act, the registrant shall register a financing statement relating to the prior security interest in accordance with this Part before the registered and perfected or perfected status of the prior security interest ceases to be effective under section 75 of the Act.

(2) Where a financing statement is registered under section 75 of the Act to continue the registered and perfected status of a prior security interest covered by an unexpired registration under prior registration law, the registrant shall

(a) indicate under which prior registration law the security interest to which the registration relates is registered;

(b) enter the registration number under prior registration law;

(c) except in the case of a prior security interest covered by a registration under the *Registration of Deeds Act*, indicate the venue in which the registration under prior registration law is registered;

(d) in the case of a prior security interest covered by a registration under the *Registration of Deeds Act*, indicate that the registration was made under that Act; and

(e) enter the date on which the registration became effective under prior registration law, with the number of the year entered first followed by the number of the month followed by the number of the day.

(3) Where a financing statement is registered under section 75 of the Act to continue the perfected status of a prior security interest that is not covered by an unexpired registration under prior registration law but has the status of a perfected security interest under subsection 75(5) of the Act on the commencement of the Act, the registrant shall enter, under the heading "Additional Information", a statement indicating when the prior security interest was created.

[12] In the Final Determination at pp. 31-32, the Trustee considered the question as to whether or not s. 26 of the **Personal Property Security Regulations** required CIBC, in its financing statement transitioning the Debenture, to also provide particulars of the registration under the prior law of the Supplemental Debentures. The Trustee determined that s. 26 of the **Regulations** did not require particulars of such prior law registration of the Supplemental Debentures. The Trustee concluded that:

> There is and has always been only One Debenture consisting of the Original Debenture dated January 27, 1995, and a series of Supplementary Debentures, each of which is expressly declared to be supplementary to and form one instrument with the Original Debenture and such Supplementary Debentures as already exist.
>
> Each Supplemental Debenture contains the following (with appropriate variations depending on the number of Supplemental Debentures then in existence):
>
> 3. The Company hereby declares, covenants and agrees with the Bank that (a) this Supplemental Debenture shall be supplementary to and form one instrument with the Debenture, the 1990 Supplemental Debenture, the 1997 Supplemental Debenture and the 1997 Second Supplemental Debenture, (b) the Debenture, the 1990 Supplemental Debenture, the 1997 Supplemental Debenture and the 1997 Second Supplemental Debenture by this reference shall be incorporated herein with the same effect as if set forth at length herein and shall for all purposes be deemed to form part hereof, and (c) unless there is something in the subject or context inconsistent herewith, expressions used in this Supplemental Debenture shall have the same meaning as ascribed to the corresponding expressions in the Debenture, the 1990 Supplemental Debenture, the 1997 Supplemental Debenture and the 1997 Second Supplemental Debenture; and
>
> 4. The Company declares, covenants and agrees with the Bank that the Debenture, 1990 Supplemental Debenture, the 1997 Supplemental Debenture and the 1997 Second Supplementary Debenture and all covenants, provisions, agreements and power contained therein and supplemented or amended by this Supplemental Debenture and the lien and security created thereby are in all respects confirmed and preserved.

> There being only One Debenture, there is only one prior security interest as defined in s. 74(1)(c) of the Act created which needs to be continued under the PPSA.
>
> . . .
>
> The PPSA creates a notice system of registration. The object of registration under the PPSA is not to provide a searcher with precise particulars of the security interest claimed or the debt it secures; it is to provide notice that a person claims a security interest in a particular asset or class of assets.
>
> A subsequent lender is put on notice of the existence of a security interest in an asset or class of assets and permitted to make inquiry of the particulars of the security. Failure to provide particulars of the registration under prior law the amending debenture would not result in a person being seriously misled. A person conducting a search would have notice of the Debenture. If affected, a person can and should make inquiry pursuant to s. 19 of the Act.

[13] CIBC purported to transition the Debenture and the Supplemental Debentures by registration under the **PPSA** of a financing statement No. 1403243 on November 29, 2001. This registration in the "General Collateral" section claimed an interest in "All of the Debtor's present and after acquired personal property as defined in **Personal Property Act**." In the "Previous Registries Registration Information" section of this financing statement, a registration date of "29 Jan. 1985" was indicated and in the "Additional Information" section of the financing statement the following additional information was supplied:

> "Demand debenture dated January 7, 1985, Registration Number Roll 77 Frame 70, Registration Date January 29, 1985, Registrar of Deeds, Newfoundland."

[14] All of the Supplemental Debentures were pre-**PPSA** security and were each registered separately in the Registry of Deeds for Newfoundland and Labrador and each had a separate Registration No. and identifying Roll and Frame No. Significantly, the Supplement Debentures had the effect, *inter alia*, of increasing the maximum amount of the obligation secured from three million dollars to twenty million dollars. None of the pre-**PPSA** registration particulars of any of the Supplemental Debentures was referenced by CIBC in this financing statement. Only the information required by the **PPSA** and Regulation 26, in respect of the original three million dollar Debenture, was referenced. In addition no reference was made to the various effective dates of the Supplemental Debentures wherein the amounts thereof were increased. This is a specific requirement of Regulation 26(2)(e). The secured creditors opposed to CIBC on this issue contend that the CIBC financing statement (as purported to transitional the Debenture and CIBC claims also transitions the Supplemental Debentures), would lead a reasonable searcher to conclude that CIBC's transitional registration relates only to a registered document dated January 7, 1985. Deere contends that, if a person attended at the Registry of Deeds for Newfoundland and Labrador and obtained a copy of the document registered at Roll 77 and Frame 70 of the Registry of Deeds, which is dated January 7, 1985 and which is referenced in the CIBC financing statement, the person

would find no indication on the face of the document that any of the Supplemental Debentures existed or were registered, nor would the person, in the course of obtaining such document, be alerted in any way to the existence of the Supplemental Debentures. They contend that on the contrary, such a person would conclude that there was no other document relied upon by CIBC.

[15] Deere contends that the only way a person searching the Registry of Deeds could discover the existence of the Supplemental Debentures would be to do a search against Hickman Equipment or a "Vide" search against the original three million dollar Debenture (as opposed to obtaining a copy of the actual security document) to which CIBC had directed the searcher. They submit that there is no expectation that a reasonable searcher would search at the Registry of Deeds in respect of personal property after December 13, 2001.

[16] Deere submits that in order to maintain the registered and perfected status of the Supplemental Debentures, CIBC was **required** by the **mandatory** provisions of Regulation 26 of the Regulations to register financing statements in the Personal Property registry within two years of the coming into force of the **PPSA** in accordance with the requirements stipulated in s. 26(2) of the Regulations and Deere submits that CIBC has not done so. Deere submits that the purpose of ss. 26(2)(a) to (e) is to provide a searcher under the PPSA system with adequate details to: (i) know the date of filing under the prior registration law, (ii) review the document as registered under the prior law, and (iii) determine the validity of the registration. They submit that, underlying the detailed requirements mandated by ss. 26(1) to 26(2) of the Regulations is the intention of the Legislature that a searcher only be required to conduct a search under the **PPSA** in order to determine the existence of security interest in personal property. They argue that hence, the requirements to provide specific information concerning pre-**PPSA** registrations, are to alert a searcher to the fact that there are pre-**PPSA** registrations that are being continued under the **PPSA** with an earlier effective priority date and to give a searcher sufficient information to obtain the registered document from the public office and examine it. They contend that the purpose is not merely to alert the searcher to the existence of a prior registration by a secured party so that the searcher can then make inquiries directly of the secured party or otherwise if he or she wishes – if that were the purpose, there would be no need to particularize the registration number, registration date, and so on. They submit that a key purpose, therefore, is to obviate the need for multiple searches and inquiries. Deere argues that had it been the intention of the Legislature that the searcher be required to make further searches and inquiries, then the mandated information would not have included the registration number, registration date, and so on, all of which are for the purpose of enabling the searcher to find and review the specific security document registered under the prior registration law to which the secured party has referenced. Upon reviewing such a document, the searcher will know the nature, scope and validity of the security interest with respect to which the secured party intends to claim a pre-**PPSA** registration date for priority determination purposes. The opposing creditors submit that even where a search reveals a financing statement registered by a secured party, persons searching the Personal Property Security Registry can be seriously mislead by the contents of the financing statement. Further, the date and details of registration by a secured party of a prior law interest which is continued by the financing statement, opposing creditors claim to be of significant importance to searchers who will use that information

to obtain and review the pre-**PPSA** security document to which they have been directed in order to assess their relevant priority. The opponents of CIBC in this regard submit that the Personal Property registry must speak for itself, and the system must have certainty and reliability built into it. They contend that the searcher should not have to wonder whether or not the registrant intended to (or might later intend to) include any other information which is required by the Legislature. The opponents of CIBC argue that any determination by this Court to find in favor of CIBC that there is no requirement to strictly comply with the mandatory provisions of the **PPSA** to transition and preserve all CIBC pre-**PPSA** security on which it intends to rely, will introduce an unacceptable element of uncertainty into the **PPSA** registration system and will destroy the integrity of the notice system intended by the Legislature.

[17] Deere submits the following two examples which they claim illustrate how a reasonable prudent lender, conversant with the search facilities, and a reasonable competent user of the registry system would be seriously misled by the CIBC financing statement which omitted to reference the Supplemental Debentures:

(i) In July 2002, a Secured Party (SP1) wishes to sell its security against a debtor to a new Secured Party (SP2). SP1 has a general security agreement covering all personal property of the debtor and it is registered on October 2001. SP2 does a **PPSA** search against the debtor and finds the registration by CIBC in November 2001 and references the document at Roll 77, Frame 70 at the Registry of Deeds (i.e. the Original Debenture) as the pre-**PPSA** registration continued by the CIBC filing. SP2 attends the Registry of Deeds and obtains a copy of the Original Debenture and concludes that CIBC has first priority security up to three million dollars in accordance with the terms of the original three million dollar Debenture. SP2 also concludes that SP1 has first priority over the remaining assets of the debtor. SP2 knows the value of the assets of the debtor are far greater than three million and purchases SP1's security. If CIBC is allowed to later assert a pre-**PPSA** priority, in reliance on the Supplemental Debentures of up to twenty million dollars worth of assets of the debtor, SP2 would have been seriously mislead to its detriment by the CIBC financing statement and the **PPSA** registration system;

(ii) in February 2000, a lender makes a **PPSA** filing for a three year period against all of the assets of a potential debtor, but does not order a post registration search since the financing transaction with the debtor is not yet finalized. On December 15, 2001, the lender and the debtor actually conclude a financing transaction, and the lender prepares to advance funds, and conducts a **PPSA** search. The search results show a registration by CIBC in November 2001 which specifically references the original three million Debenture as the only pre-**PPSA** registration which is continued by the filing. The lender attends at the Registry of Deeds and obtains a copy of the only transitioned document referred to in the CIBC financing statement, namely the original three million dollar Debenture. The lender knows that the value of the assets of the debtor are greater than three million dollars and concludes it is second in priority to CIBC, and first in respect of the assets of the debtor greater in value than three million dollars, because the only filing ahead of the lender at the time of perfection is CIBC in respect of its transitioned original three million dollar

> Debenture. If CIBC is later allowed to assert a pre-PPSA security, in reliance on the Supplemental Debentures of up to twenty million dollars worth of assets of the debtor, the lender would have been seriously mislead to its detriment by the CIBC financing statement and the **PPSA** registration system.

[18] Deere submits that the Court should not allow a secured party like CIBC to successfully resort to the curative provision of s. 44(7) of the **PPSA** to cure its omission in failing to refer to the Supplemental Debentures in its financing statement, when that financing statement does not include the information required by s. 26 of the Regulations. They contend that such a cure would create a level of uncertainty and inefficiency in the registration system never intended by the Legislature. One effect would be to force users to make inquiry of every secured party who registered a financing statement prior to the termination of the two-year transition period on December 13, 2001, which references a specific pre-**PPSA** registration whether or not its registration also purports to continue any other prior law registration not referenced in the financing statement. They contend that this would create a level of uncertainty directly in conflict with the policy implicit in the imperative statutory and regulatory requirements. This would clog efficient operation of the system by making it necessary for users of the system to make additional searches or inquiries of secured parties like CIBC to find out if, despite what they had chosen to record in their registration, they might in fact later purport to claim a significantly different security interest, including a security interest where the amount of the obligation purported is much greater than the amount expressly stated in the publicly filed document to which the searcher had been directed. They therefore submit that CIBC cannot and should not, from a policy perspective, be permitted to rely upon its pre-**PPSA** date of registration to give it priority for more than three million dollars. They further submit that for the same reasons, the earliest date of perfection which can be claimed by CIBC in relation to the obligation secured by the Supplemental Debentures is January 25, 2000, that being the earliest date of the CIBC filing under the **PPSA**.

[19] CIBC, and the creditors supporting its position in this application, contend that the only items that the transition sections of the **PPSA**, namely ss. 74 and 75, deal with is the transition of a "security interest" or "security interests".

[20] "Security interest" is defined in s. 2(pp) of the **PPSA** and, *inter alia*, means:

> "(i) an interest in personal property that secures payment or performance of an obligation ..."

[21] CIBC and its supporters contend that nothing in the definition of a "security interest" contains any reference to the dollar amount secured thereby. They argue that as a result, all that is necessary for a holder of prior law security to do in order to preserve its prior law "security interest" is to transition under s. 74 of the **PPSA** and Regulation 26, the document which creates the "security interest". They contend that of the Debenture and the Supplemental Debentures, only the Debenture actually creates a security interest, i.e. creates an interest in personal property.

[22] Section 2.1 of the Original Debenture states under the heading "Security":

> "2.1 As security for the due payment of all moneys payable hereunder the Company as beneficial owner hereby: ... charges as and by way of a first floating charge to and in favor of the Bank, its successors and assigns all its undertaking, property and assets, both present and future, of every nature and kind and wherever situate (other than such as are at all times validly subjected to the first fixed and specific mortgage and charge hereby created) including, without limitation, its franchises and uncalled capital. ..."

[23] CIBC and its supporters contend that the Supplemental Debentures do not, in their own right, create a security interest in the sense that they do not, in accordance with the definition of "security interest" contained in s. 2(pp) of the **PPSA**, create an interest in property. CIBC contends that the Supplemental Debentures are totally supplemental to and one with the Debenture and they point to clauses contained in the Supplemental Debentures which make that statement. The following is s. 3 of the July 9, 1998 Supplemental Debenture, which wording is in all material aspects, similar to the three other Supplemental Debentures, namely:

> "The company hereby declares, covenants and agrees with the Bank that (a)this Supplemental Debenture shall be supplementary to and form one instrument with the Debenture, the 1990 Supplemental Debenture, the 1997 Supplemental Debenture and the 1997 Second Supplemental Debenture, (b) the Debenture, the 1990 Supplemental Debenture, the 1997 Supplemental Debenture and the 1997 Second Supplemental Debenture by this reference shall be incorporated herein with the same effect as if set forth at length herein and shall for all purposes be deemed to form part hereof, and (c) unless there is something in the subject or context inconsistent herewith, expressions used in this Supplemental Debenture shall have the same meaning as ascribing to the corresponding expressions in the Debenture, the 1990 Supplemental Debenture, the 1997 Supplemental Debenture and the 1997 Second Supplemental Debenture."

[24] CIBC refers to the case of **Canadian Commercial Bank v. Greenwood Forest Products (1969) Ltd. et al** (1985), 66 B.C.L.R. 145 (D.C.C.A.). In this case the plaintiff bank held a Debenture and six Supplemental Debentures. A certified copy of each Supplemental Debenture was filed with the Registry of Companies as required by British Columbia law but were not accompanied by a certified copy of the companies' authorizing resolutions. The Chambers Judge concluded that the Supplemental Debentures were independent debentures and, as certified copies of the authorizing resolutions had not been registered as required by s. 75(3) of the **Company Act**, they were void as against the Court appointed Receiver-Manager who was also the Trustee in Bankruptcy. The bank appealed and the Court of Appeal held that the Supplemental Debentures were valid as against the Trustee and Receiver-Manager. At p. 149 of the Court of Appeal decision the Court per Carrothers, J.A. states:

> "The distinguishing feature of these particular supplemental debentures is that they have referenced to the original debenture and purport to amend certain aspects of

> that original debenture. The supplemental debentures purport to expand the principal sum secured by the original debenture by increasing increments and to alter the interest rate. They each confirm the original debenture as amended and leave intact the conditions attached to the original debenture without establishing any conditions of their own.
>
> In my view, the supplemental debentures made inseparable reference to and are inexorable involved with the original debenture. They must be construed and categorized as amending debenture, thereby precluding their independent existence.
>
> I consider it inconsistent, illogical and in error to construe the supplemental debentures in this case as independent debentures solely for the purpose of ascertaining whether they have been registered in accordance with the **Company Act**."

[25] Additionally at p. 149 the Court states:

> "I am of the opinion that the supplemental debentures, as amending debentures, could appropriately be considered to have been filed with the Registrar of Companies as a notice of 'any other change concerning the mortgage' pursuant to s. 77. No one can determine under what section they were indeed filed. The fact is they were matters of record in the office of the Registrar of Companies."

[26] At p. 150, Anderson J.A., in expressing concurrence with the foregoing comments by Carrothers, J.A. states:

> "I would further hold that the filing pursuant to s. 77 constitutes registration. If I am wrong in that view, it is my view that filing under s. 77 at the very least amounts to constructive notice that the original debenture has been amended in accordance with the documents filed pursuant to s. 77. Although it is not necessary for us to so decide, I express great doubts as to whether the holder of the original debenture could obtain priority with respect to an increased indebitness secured by the amending debentures without giving notice by filing."

[27] I take this case as providing authority for the proposition that the Debenture and the Supplemental Debentures in the case at bar in fact and in law constitute one debenture. However, in my view, the question of notice to subsequent creditors remains unanswered by this decision. Clearly in the Registry of Companies in British Columbia, a person searching in the name of the debtor in this case could not have avoided becoming aware of the existence of the Supplemental Debentures. They were filed in the company file which the searcher was obliged to search. There is no reference in the decision to any index to the company file serving as the search vehicle. On the notice issue, the case seems to turn upon whether strict technical compliance with the requirement for authorizing resolutions was necessary in order to constitute notice of the Supplemental Debentures. There was nothing in the methodology of registration of the

Supplemental Debentures which could be construed as "misleading".

[28] S. 75(14)(b) of the **PPSA** states:

> (14) Where the perfection of a prior security interest that is considered registered or perfected under this section is continued by registration under this Act,
>
> ...
>
> (b) The registration supersedes a registration or perfection under prior law.
>
> [Emphasis added.]

What is the purpose of this subsection? Clearly, the continuation registration under the **PPSA**, in the words of s. 75(14)(b) "supersedes" the prior registration law registrations. I am satisfied that the intended purpose of this subsection was to create, after the termination of the two-year transition period, a single registry in which to search for notice of consensual security interest in personal property, i.e., the Personal Property registry established under the **PPSA**.

[29] After the expiry of the two-year transition period established by s. 75 of the **PPSA**, what continuing purpose can be ascribed to the requirements of regulation 26 that a lender include in its transition registration particulars of prior registration law security registrations such as (i) the law the interest is registered under; (ii) the registration number; (iii) the venue of registration; (iv) whether the prior interest is registered under the **Registration of Deeds Act**; and (v) the effective date of the prior registration?

[30] S. 85 of the **PPSA** repeals the assignment of **Book Debts Act**, the **Bills of Sale Act** and the **Conditional Sales Act**. Section 77 of the **PPSA** amends the definition of "property" under the **Conveyancing Act** so as not to include "...personal property as defined in the **Personal Property Security Act**." The effect of these repeals and this amendment was to leave in place only one registry for the registration of notices of consensual personal property security interests, namely, the Personal Property registry established under the **PPSA**.

[31] Counsel for General Motors Acceptance Corporation ("GMAC"), a creditor supporting CIBC's position in these applications, postulated that the requirements of Regulation 26 with respect to registration details required for financing statements transitioning prior registration law security only served a useful purpose and was only intended to be effective during the two-year transition period. He suggests that this prior law registration information only served a useful purpose while the old registration systems, and the **PPSA**, were both open and readily accessible to the public for searching during the transition period. This dual availability permitted searchers to obtain copies of the actual prior registration law security agreements without having to make a request of the lender under s. 19 for information about its security. He submits that at the end of the

two-year transition period searchers were never again intended to do document searches as the **PPSA** was intended to operate as a pure "notice" registry system. Therefore, searchers would be forced to make s. 19 **PPSA** requests for information from the various lenders who had filed transitioning financing statements.

[32] Regrettably, the drafters of the **PPSA** and its Regulations did not in any way hint at any intended limitation period for the usefulness of the prior law registration information. Creditors opposed to CIBC point to s. 74(7) of the **PPSA** dealing with the searchability of prior law registries to support their arguments. The section reads:

> (7) Notwithstanding the commencement of this Act and the repeal of prior registration law, prior law is considered to continue in force and registrations made under prior registration law shall remain searchable to the extent necessary to give effect to this section and section 75.

Creditors opposed to CIBC point to this section as indicating a continuing intent on the part of the drafters of the legislation to allow searchers access to the old registration systems to search for security agreements registered thereunder and referred to in transitioning financing statements.

[33] The matter is further complicated by the fact that after the end of the two-year transition period, the Registry of Bills of Sale and Conditional Sales was no longer generally accessible to the public. It is argued by CIBC and GMAC that this supports the contention that the Personal Property registry was intended to be the only place to search for notice of security interests in personal property. There is an anomaly to the argument, however. The Registry of Deeds, which was not closed at the end of the two-year transition period, was the place where Debentures were required to be registered under the prior law. It continues in operation as a registry for instruments related to land. Thus, it is readily accessible to searchers and this fact would have been known to the drafters of the **PPSA** and its regulations. The creditors opposed to CIBC argue, therefore, that the drafters of the legislation intended searchers to continue to search this registry after the two-year transition period, as part of the normal search process.

[34] CIBC and its supporters point to s. 75(14)(b) of the **PPSA** which provides that a continuation registration "supersedes" a prior law registration and claim that this points to the death of the prior law registration system as a search tool. They contend that s. 74(7) intended that the prior law registration systems were not intended to continue in operation for any purpose other than:

> (i) to allow examination of an original registered document to determine compliance with prior law;
> (ii) to determine the effective dates thereof;
> (iii) to determine perfection and priorities between prior law security interests.

[35] They contend these are the only valid purposes to require access to the old registrations

systems and this is what is intended by s. 74(7) of the **PPSA** when it provides that the old registries remain searchable "... to the extent necessary to give effect to this section and to s. 75."

[36] Counsel for Deere provided two examples where it claimed that the failure of CIBC to include registration information of Supplemental Debentures was seriously misleading. These are referred to in par. [17] hereof. Each of these hypothetical situations was predicated upon the assertion that a searcher, because she/he had only been referred to the Debenture by the CIBC transitioning financing statement, would reasonably conclude that the Debenture was limited to securing, for all eternity, the maximum sum of $3,000,000. However, it is clear that the **PPSA** registration system is intended to operate as a "notice" form of registry. The registry is not intended to be the place where a searcher obtains the actual security document. I am satisfied that this was the intent of the drafters of the legislation, even as it relates to obtaining copies of transitioned security agreements registered in the old registries. If this was not the intent, then what is the purpose:

(i) Of s. 74(14)(b) of the **PPSA** providing that a continuation registration "supersedes" a prior registration law registration; and

(ii) s. 74(7) of the **PPSA** limiting the searchability of the old registries "... to the extent necessary to give effect to this section and s. 75.

[Emphasis added.]

[37] I am satisfied that registration of any financing statement indicating a security interest (whether on original filing or transitional filing) is not required to indicate the dollar limit, or cap, on that security interest. This is supported by the statutory definition of "security interest" contained in the **PPSA** which makes no reference to a monetary amount. A *fortiori*, once the Debenture was transitioned, there is no statutory or regulatory obligation to register notice of a change to that Debenture increasing the amount secured. A searcher would simply become aware of the Original Debenture and, being aware that there was no requirement in the **PPSA** to register a notice of amending agreements increasing the amount secured as agreed between the original parties, would request information of the secured lender, or whether there were such amending agreements. The statutory definition of a "financing change statement" does not contain any reference to a financing change statement requiring information about the amount secured by the security agreement. Regulations 19 to 25, dealing with registration of financing statements, make no reference to a requirement to register a dollar limit on the security interest. Regulations 53, 54 and 55, dealing with registration of change statements, similarly do not require registration of an amendment to a security agreement between original parties thereto whereby the amount secured is increased.

[38] The hypothetical situations posed by counsel for Deere, where they claim that searchers would be seriously misled by only receiving notice of the Debenture, are flawed by the assumption that the Debenture (or for that matter the Supplemental Debentures) remain written in stone. There being no statutory or regulatory requirement for CIBC to register changes to the Debenture (or the

Supplemental Debentures) after they were transitioned, would indicate that this assumption on the part of Deere is a fatal misassumption and any searcher relying on such an assumption would be negligent. The Debenture could have been amended or increased in amount on the very same day as CIBC registered its transitioning financing statement without any requirement for CIBC to file notice of such amendment.

[39] Deere's counsel has also contended that the transitioning financing statement of CIBC is "seriously misleading" because it fails to include the effective dates of the Supplemental Debentures. With respect, such an omission is not seriously misleading. The transitioning financing statement of CIBC does contain the earliest effective date of the Debenture as 29 January 1985. Any searcher would know this is the earliest effective date of the original security and would be put on notice to make inquiries of CIBC under s. 19 of the **PPSA** as to what security was now in place and whether any changes had been made to the Debenture.

[40] Counsel for Deere also suggests that the failure of the CIBC transitioning financing statement to reference the Supplemental Debentures is seriously misleading in that it would induce a searcher into making a request of CIBC pursuant to s. 19 of the **PPSA** asking only for a copy of the Debenture (and not the Supplemental Debentures) as that is the only prior law registration law document referred to in the transitioning financing statement. Counsel contends that CIBC, receiving such a request, would only be obliged to provide a copy of the Debenture (and not the Supplemental Debentures) as that would be all that a searcher would reasonably be expected to request of CIBC with respect to prior law registration. Deere counsel contends there is no sanction or penalty imposed by s. 19 on CIBC for failing to reveal the Supplemental Debentures when only asked for a copy of the Original Debenture. That may be so, but it places the emphasis in the wrong place. In my view, a searcher requesting a copy of only the Original Debenture would be seriously negligent, as such searcher must be taken to know that, after registration of the transitioning financing statement, the Debenture could have been freely amended by the parties without any further registrations being required. That being the case, a prudent searcher would request information with respect to any amendments to the Debenture. In making such a request, it would have received notice of the Supplemental Debentures. Furthermore, in the facts of this case, the Supplemental Debentures are one with the Original Debenture and, in my view, CIBC, on receiving a request for a copy of the Original Debenture, would be bound under s. 19(3) to provide a copy of the Debenture and copies of the Supplemental Debentures as they are part of the "security agreement" referred to in that section. If CIBC only provided a copy of the Debenture (and not the Supplemental Debentures), s. 19(14) of the **PPSA** would have estopped CIBC from denying that the Debenture was the only Debenture security.

[41] Counsel have not provided me with any case law dealing directly with the types of issues raised by Regulation 26, or its statutory or regulatory equivalence in other jurisdictions. They have referred me to my January 3, 2003, decision in the Wells Fargo application found in **Hickman Equipment (1985) Ltd., (Re)** [2003] N.J. 1. That decision, while it also dealt with Regulation 26, and its transitioning requirements, is distinguishable from the case at bar. In the Wells Fargo application, Wells Fargo had made no reference at all to any prior registration law security in its transitioning financing statement. It was logical, in that case, therefore, for searchers to assume that

Wells Fargo held no security which predated its first **PPSA** financing statement. Thus, the incomplete financing statement was seriously misleading. For the reasons stated above, the postulated assumption would not be reasonable on the part of a searcher in the case at bar due to the fact that the Debenture is referred to in the transitioning financing statement, and could have subsequently been amended. The searcher would have had Notice of Debenture from the CIBC transitioning financing statement unlike the hypothetical searcher in the Wells Fargo application who would have no notice from the Personal Property registry of the existence of the pre-**PPSA** security held by Wells Fargo.

[42] I conclude, therefore, that the financing statement of CIBC dated November 29, 2001, registered in the Personal Property registry as Registration No. 1403243 is not seriously misleading by reason of its failure to reference the Supplemental Debentures and is, therefore, effective to transition the prior law registrations by CIBC not only of the Debenture dated January 15, 1985, but also of the Supplemental Debentures dated February 19, 1990; April 17, 1997; August 6, 1997; and July 15, 1998. No party to these applications has challenged the validity and enforceability of these contracts under the prior law. I therefore find these agreements are valid and enforceable in accordance with their terms, as against subsequent creditors with effective dates as of their respective dates of registration in the Registry of Deeds. It should be noted that I have emphasized in this paragraph the words "enforceable in accordance with their terms." I have emphasized these words because one of the other grounds of appeal of CIBC hereunder is against the Final Determination by the trustee that the Debenture (with which the Supplemental Debentures are construed as one agreement) contained provisions subordinating the Debenture (and the Supplemental Debentures) to the interests of holders of Permitted Encumbrances including, *inter alia*, Unperfected PMSI holders. That issue will be dealt with later in this judgment.

Validity of CIBC Security under the Bank Act

[43] In the Final Determination, the Trustee determined that the CIBC security under the **Bank Act**, Statutes of Canada, 1991 c. 46 was invalid. It made this Final Determination on two grounds:

1. That the Notice of Intention to Give Security registered by CIBC in the **Bank Act** registry, was not registered before the **Bank Act** Security was executed; and

2. that the **Bank Act** Security was invalid on the grounds that the description of the assets to be charged was too imprecise.

[44] It is not necessary for me to decide this second issue with respect to the imprecision of the description of the **Bank Act** Security because I have concluded that the **Bank Act** Security is invalid by reason of the failure of CIBC to file a Notice of Intention to Give Security in the **Bank Act** registry before the s. 427 **Bank Act** Security was given by Hickman Equipment to CIBC. S. 4(a) of the **Bank Act** provides:

> (4) The following provisions apply where security on property is given to a bank

under this section:

> (a) The rights and powers of the bank in respect of property covered by the security are void as against creditors of the person giving the security and as against subsequent purchasers or mortgagees in good faith on the property covered by the security unless a Notice of Intention signed by or on behalf of the person giving the security was registered in the appropriate agency not more than three years immediately before the security was given. . .

CIBC has acknowledged that the Notice of Intention to Give Security, upon which it was relying, was not registered by it in the appropriate **Bank Act** registry until eight days after Hickman Equipment promised to give, and gave, security under the **Bank Act** to CIBC. CIBC contends that upon execution of the **Bank Act** Security, CIBC acquired legal title to the property assigned to it by Hickman and it relies upon the Supreme Court of Canada decision in **Bank of Montreal v. Hall** (1990), 65 D.L.R. (4^{th}) 361 at 370 for the proposition that a bank taking security under the **Bank Act** effectively acquires title to the borrower's interest and the present and after acquired property assigned to it by the borrower. This case held that the bank's interest attaches to the assigned property when the security is given, or the property is acquired by the borrower and remains attached until released by the bank, despite changes in the attributes or composition of the assigned property. The borrower retains an equitable right of redemption, but the bank acquires legal title to whatever rights the borrower holds in the assigned property from time to time. CIBC contends that, based upon this principle from the **Bank of Montreal v. Hall** case, the failure to register the Notice of Intention before the execution of the **Bank Act** Security, did not affect the validity of the Security, but merely rendered it voidable as against Hickman's creditors and that it thus constituted constructive notice to the world of the bank's interest in property covered by the security. It cites in support of this decision the case of **Davanti Contemporary Interiors Ltd. (Re),** [1992] 6 W.W.R. 636 (Alta. Q.B.). In **Davanti** a company had given a bank a written Notice of Intention under s. 178 of the then **Bank Act** and the same day executed an assignment of its inventory. The Notice of Intention was registered after the assignment was given. The company defaulted and the bank seized the inventory. The inventory was left in the company's possession under a sub-agency agreement by which the company was to liquidate the inventory. The company subsequently made an assignment in bankruptcy. The Trustee sought a declaration that the s. 178 security was null and void as against the Trustee, because the Notice was registered after the

security was given.

[45] I am satisfied that this case is distinguishable upon its facts from the case at bar. In **Davanti** the Court held that s. 178 was intended to benefit borrowers, not banks. Its meaning was clear and unambiguous, namely that a Notice of Intention is required to be registered before security given. The registration by the bank, therefore, was imperfect. The Court held, however, that the bank's security was not, however, void, but voidable at the instance of a creditor. The assignment by the company was a valid conveyance of an interest in the inventory. When the bank seized the inventory, no creditor had moved to trigger its rights as a creditor, nor had the Trustee in Bankruptcy been appointed. The bank, therefore, completed its act of ownership by taking possession of the inventory. The sub-agency agreement did not alter the fact that the inventory was then owned by it and in the legal possession of the bank. By the time the Trustee was appointed, it was too late to void the bank security. The inventory was no longer the property of the bankrupt within the meaning of s.67 of the **Bank Act**.

[46] The factual distinction between **Davanti** and the case at hand, of course, is that CIBC had never taken possession of the inventory of Hickman Equipment over which it held security pursuant to the **Bank Act** at any time prior to the CCAA Order issued by this Court in respect of Hickman Equipment or prior to the subsequent Receiving Order. The Notice of Intention to Give Security not having been registered with the Bank of Canada agency prior to the taking of the s. 427 security, I find that the s. 427 **Bank Act** Security claimed by CIBC is invalid and unenforceable as against the Trustee in Bankruptcy and the secured creditors of CIBC (see the following for support of this finding: **Discovery Enterprises Inc. v. Hong Kong Bank of Canada** (1997), 7 B.C.L.R. (3rd) 385 (B.C. C.A.) and **The Canadian Imperial Bank of Commerce v. 281787 Alberta Ltd. (Crockett's Western Wear)** (1984), 9 D.L.R. (4th) 765 (Alta. C.A.)).

Validity and Enforceability of General Security Agreement dated January 25, 2000

[47] On January 28, 2000 CIBC filed in the Personal Property registry a registration statement number 78490 naming Hickman Equipment as the debtor. In the "General Collateral" box on the registration statement CIBC claimed a security interest in:

> "All the Debtor's present and after acquired personal property as defined in **Personal Property Security Act**."

[48] Three days prior to the filing of that financing statement in the Personal Property registry, i.e. on January 25, 2000, CIBC obtained from Hickman Equipment a document entitled "Security Agreement". In that agreement Hickman covenanted as follows:

> "For valuable consideration, the undersigned, the "Customer", agrees with Canadian Imperial Bank of Commerce ("CIBC") as follows:
>
> 1. **Grant of Security**. The customer mortgages, charges and assigns to CIBC,

> and grants to CIBC, and CIBC takes, a Security Interest in the property described in the following paragraph or paragraphs of this section (as applicable in accordance with the note appearing at the end of this section), and in all property described in any schedules, documents or listings that the customer may from time to time sign and provide to CIBC in connection with this Agreement, and in all present and future Accessions to, and all proceeds of, any such property (collectively, the "Collateral") as a general and continuing security for the due payment of performance of the Liabilities;"

Immediately after the quoted section there were a number of sections of text which were to be selected by the grantor by ticking the appropriate box. The appropriate box ticked was that which read:

> "**(b) All Personal Property:** All of the customer's present and after-acquired undertaking and Personal Property (including any property that may be described in Schedule A)."

[49] Prior to the registration of this financing statement and the execution of the Security Agreement (the "GSA") Hickman Equipment and CIBC had regularly executed documents, in the form of letters addressed by CIBC to Hickman Equipment, which had been entitled "Credit Agreement" (the "Credit Agreements"). Three such letters entitled "Credit Agreement" were attached as exhibits to the affidavit of Jennifer Lee, the principal deponent in this matter on behalf of CIBC. All of these were dated before the GSA was executed on January 25, 2000, the latest being dated June 26, 1998. There were two other letters also appended to the Lee affidavit but they were for the year 2000 and did not carry the title "Credit Agreement". All of the parties hereto nonetheless have called these latter two letters by the name "Credit Agreement". In the June 29, 1998 Credit Agreement (the "'98 Credit Agreement"), CIBC indicated that it had established in favor of Hickman Equipment various demand credit facilities, each being defined therein as a "Facility". There were several Facilities mentioned, namely: (1) An Operating Facility; (2) A Revolving Rental Loan Facility; (3) Two Demand Installment Loans, and (4) Letters of Credit. The '98 Credit Agreement provided that security for Hickman Equipment's obligations to CIBC included:

> "All security CIBC may now and from time to time hold plus: ..."

and it specifically listed security, including a general assignment of book debts, **Bank Act** security, the debenture previously mentioned in this judgment, but not including the GSA.

[50] I am satisfied that nothing in the '98 Credit Agreement prohibited CIBC from taking the GSA from Hickman Equipment on January 25, 2000. At that time the GSA constituted a distinct and separate Security Agreement negotiated between Hickman Equipment and CIBC, and no

evidence was presented to me that any then existing agreement between CIBC and Hickman Equipment constrained, reduced, diminished or rendered invalid or ineffective the provisions of the GSA. Thus the GSA, when given, became both a contract between the parties and part of the security held by CIBC. I am satisfied that it created a security interest, i.e. an interest in personal property that secured payment or performance of Hickman Equipment's liabilities or obligations to CIBC, whether they arose under the '98 Credit Agreement or otherwise. There is nothing in the wording of the GSA which restricts it in any way to being governed by the terms of the '98 Credit Agreement, either by being limited to securing the various Facilities mentioned therein or its effectiveness being tied to the terms of the '98 Credit Agreement. It is a stand alone piece of security negotiated by and agreed to by Hickman Equipment and CIBC.

[51] In April 2000, a new Credit Agreement was entered into between CIBC and Hickman Equipment (the "April 2000 Credit Agreement"). The April 2000 Credit Agreement was, in turn, replaced by a further new Credit Agreement dated June 19, 2000 (the "June 2000 Credit Agreement"). The June 2000 Credit Agreement was the Credit Agreement in effect between Hickman Equipment and CIBC on the date of bankruptcy.

[52] The April 2000 Credit Agreement provided:

> "Upon acceptance, this agreement replaces the existing Credit Agreement dated June 28, 1998, between you and CIBC. Outstanding amount (and security) under that agreement will be covered by this agreement."

[53] The June 2000 Credit Agreement provides:

> "Upon acceptance, this agreement replaces the existing Credit Agreement dated April 18, 2000, between you and CIBC. Outstanding amount (and security) under that agreement will be covered by this agreement."

[54] Each of the April and June 2000 Credit Agreements stated, in respect of security:

> "The following security is <u>required</u> ..." [Emphasis added.]

and specific security is listed then, including the general assignment of book debts, **Bank Act** security, the Debenture, and guarantees with supporting collateral and postponement of claim from other companies in the Hickman group of companies.

[55] The GSA is not listed as part of the "<u>required</u>" security in either the April or June 2000 Credit Agreements. Neither did the 2000 Credit Agreements include the phrase contained in the '98 Credit Agreement which provided security for Hickman Equipment's obligations to CIBC included "All security CIBC may now and from time to time hold plus ..."

[56] In its Final Determination the trustee determined that on the acceptance of the 2000 Credit

Agreements, the GSA ceased to constitute a valid, enforceable security interest in the Assets of Hickman Equipment as security for the liabilities of Hickman Equipment to CIBC in respect of the Credit Facilities made available to Hickman Equipment pursuant to the Credit Agreements. The Trustee took the position, relying on statements by G. H. L. Fridman in **Law of Contracts**, Carswell 4th Edition 1999, at pp. 478 - 479 where it is stated:

> "If the parties have seen fit to put their contractual intentions into writing, it must be because they wanted their meaning to be clearly and unequivocally established. There should be no room for argument about what has been agreed. The written word should make plain beyond doubt or question what were the requirements of the contract that was entered into by the parties.
>
> ... The golden rule is that the literal meaning must be given to the language of the contract, unless this would result in an absurdity. Words of ordinary use in a contract must be construed in their ordinary and natural sense. The paramount test of the meaning of the words in a contract is the intention of the parties. That is to be determined in the operative sense by reference to the surrounding circumstances at the time of signing the contract. But evidence of the commercial context surrounding the making of an agreement may be admitted only to show the purpose for which the various contractual provisions were included, not to vary the meaning of the words of a written contract."

[57] The Trustee went on to conclude that the terms of the 2000 Credit Agreements were clear in that they describe the Credit Facilities and the security required for the provision of the Credit Facilities. The security required was listed and the GSA was not listed as part of the security required. As additional support, the Trustee cites condition 1.17(b) of the standard terms and conditions attached to these 2000 Credit Agreements relating to the use of the Facilities and relating to security, namely:

> "1.17(b) All the <u>required</u> security has been received and registered to our satisfaction ..." [Emphasis added.]

[58] The Trustee took the position that CIBC was the one who drafted the 2000 Credit Agreements. If it had wished to require a GSA as part of the "required security" it could have listed it. It did not. The Trustee determined that the last paragraph of the Credit Agreements which states:

> "Upon acceptance this Agreement replaces the existing Credit Agreement dated June 26, 1998, between you and CIBC. Outstanding amounts (and security) covered by that Agreement will be covered by this Agreement."

means that the only security for the Facilities is the security required by the 2000 Credit Agreements. They do not incorporate by reference all pre-existing security which had not been specifically released or returned. If the latter was the case, there would have been no need to refer

in the Credit Agreement to the general assignment of book debts, **Bank Act** security or postponement of claim by Hickman Motors, all of which had been required in earlier Credit Agreements.

[59] As stated earlier in this judgment at par. [50], at the time the GSA was entered into between Hickman Equipment and CIBC, the GSA was a valid and enforceable security agreement because nothing in any previous agreement between these parties shown to me restricted in any way the right of Hickman Equipment to give such security and the right of CIBC to obtain it. The GSA had attached to it a schedule entitled "Additional Terms and Conditions". Article 10(3) of those Additional Terms and Conditions stated:

> "**(3) Other Legal Rights.** Both before and after default, CIBC will have, in addition to the rights specifically provided in this agreement, the rights of a secured party under the PPSA, as well as the rights recognized at law and in equity. No right will be exclusive of or dependant upon or merge in any other right, and any one or more of such rights may be exercised independently or in combination from time to time."

[60] Additionally, par. 14 of those Additional Terms and Conditions states:

> "**14. Dealings by CIBC.** CIBC may from time to time increase, reduce, discontinue or otherwise vary the customer's Credit Facilities, grant extensions of time or other indulgences, take and give up any Charge, abstain from taking, perfecting or registering any Charge, accept compositions, grant releases and discharges and otherwise deal with the Customer, customers of the Customer, guarantors and others, and with the Collateral and any Charges held by CIBC, as CIBC considers appropriate without affecting the Customers' obligations to CIBC or CIBC's rights under this agreement."

[61] Additionally, in par. 15 of the Additional Terms and Conditions, the word "Charge" is defined as follows:

> "**'Charge'** means any mortgage, charge, pledge, hypothecation, lien (statutory or otherwise), assignment, financial lease, title retention agreement or arrangement, security interest or other encumbrance howsoever arising, or any other security agreement or arrangement creating in favor of any creditor a right in respect of a particular property that is prior to the right of any other creditor in respect of such property."

[62] It is clear to me that on January 25, 2000 when CIBC entered into the GSA with Hickman Equipment, the parties entered into a contract wherein they established contractual rights and obligations as between them, including, but not limited to, security rights over collateral. One of the rights which CIBC obtained under term 10(3) of the Additional Terms and Conditions to the GSA was a right that rights provided in the GSA would not be "dependant upon or merge in any

other right, and one or more of such rights may be exercised independently or in combination from time to time."

[63] I take this section to mean that absent a clear statement of intention on the part of the parties to the GSA that the rights thereunder are agreed to be terminated, that the rights of CIBC under the GSA continue independently and do not "merge in any other right" which CIBC may have had or may in the future have obtained from Hickman Equipment. Additionally, under par. 14 CIBC had the right to both obtain charges from CIBC and release same and a charge is defined in s. 15 as including a "security interest".

[64] Section 51 of the **PPSA** deals with compulsory discharges. Subsection 3 thereof states:

> "(3) The debtor, or a person with an interest in property that falls within the collateral description included in a registered financing statement may give a written demand to the secured party if
>
> (a) all of the obligations under the security agreement to which the financing statement relates have been performed;
>
> (b) the secured party has agreed to release part or all of the collateral described in the collateral description included in the financing statement; ..."

[65] The section goes on to give rights to the debtor to make application to Court for an order discharging the registration where the creditor refuses to do so in the proper circumstances. No evidence was presented which indicated that Hickman Equipment ever demanded that CIBC release or discharge the GSA. If indeed it had been intended by the parties to not be operative, its release may well have been an advantage in giving additional financing flexibility to Hickman Equipment. Affidavit and *viva voce* evidence was given on behalf of both CIBC and Hickman Equipment to the effect that it was the intention of these two parties that the GSA continue in force and effect and that they had, in effect, an oral agreement that was the case. However, it is not necessary for me to even consider such extrinsic evidence. There are many situations arising in normal banking relationships between a bank and its customer whereby the customer may become indebted to the bank. These are not limited to revolving loans, fixed term loans, letters of credit, etc. or other arrangements of the type of "Facility" referred to in the various Credit Agreements. Debts may well have arisen between CIBC and Hickman Equipment simply by means of operation of the bank accounts of Hickman Equipment with CIBC. It is common knowledge that various account operation agreements utilized by the chartered banks in Canada all make provision that overdrafts in bank accounts constitute a debt owing by the customer to the bank. No such debts are referenced in the Credit Agreements. Does that mean that those debts are not secured? Do the 2000 Credit Agreements limit the listed security only to securing the Facilities mentioned therein despite the more general wording of the specific security documents making them security for all of the indebtedness of Hickman Equipment to CIBC? While CIBC has chosen to identify these various letter agreements as "Credit Agreements" typically bankers and their customers have also called

them "commitment letter", "term sheet", "offer to finance" and the like. I am satisfied that in cases where commercial banks intend such arrangements to be totally definitive of the debtor/creditor relationship between the bank and its customer, considerably more detail is incorporated into far more formal documents usually entitled "Loan Agreements". I am not satisfied that the Credit Agreements were intended to be the sole document governing the debtor/creditor relationship between Hickman and the bank, whether arising by way of loans, Facilities or by way of the operation of accounts. The 2000 Credit Agreements do not contain "Entire Agreement" clauses. Such an omission, deliberate or otherwise, sanctions the taking of other security agreements such as the GSA. I do not interpret the word "required" insofar as it relates to the security delineated in the 2000 Credit Agreements as meaning that the delineated security was the "only security required" or the "only security now in force". Hickman Equipment was a large and sophisticated business operation which was part of an even larger and equally sophisticated group of companies. It had to be taken to know its rights which included the right to have the registration of the financing statement registered in the Personal Property registry in relation to the GSA discharged if such security document was no longer intended to be in force and effect. Common sense says that Hickman, if so concerned, would have asked for a release. There was no evidence that it did so. I am not satisfied that the 2000 Credit Agreements constituted any intent either on the part of Hickman Equipment or CIBC to release or discharge the GSA.

[66] No party to these proceedings has contested the validity and enforceability of the GSA on any grounds other than those set out in the portion of this judgment relating to the GSA. I therefore conclude that the GSA is valid and enforceable. Again it is necessary to note that one of the other grounds of appeal of CIBC hereunder is against the Final Determination by the Trustee that the GSA was subject to certain provisions of the Credit Agreements and to certain provisions in the Debenture granting interests in the assets of Hickman Equipment to the holders of Permitted Encumbrances including, *inter alia*, Unperfected PMSI holders. That issue will be dealt with later in this judgment. Therefore my finding that the GSA is valid and enforceable is subject to whatever limitation, if any, it may be subject to with respect to Permitted Encumbrances.

Are the Debenture and the GSA subordinated to the interests of "Permitted Encumbrances" including Unperfected PMSI Holders?

[67] The Debenture contained the following clause:

> "2.2 Until the security becomes enforceable, the Company may dispose of or deal with the subject matter of the floating charge in the ordinary course of its business and for the purpose of carrying on the same, provided that the Company will not, without the prior written consent of the Bank, create, assume, or have outstanding, except to the Bank, any mortgage, charge or other encumbrance on any part of the Charged Premises ranking or purporting to rank or capable of being enforced in priority to or pari passu with the Security, other than any mortgage, lien or other encumbrance upon property, created or assumed to secure all or any part of the funds required for the purchase of such property or any extension or renewal or

replacement thereof upon the same property if the principal amount of the indebitness secured thereby is not increased, or any inchoate liens for taxes or assessments by public authorities."

[68] The GSA contains the following clause:

> "4. Collateral Free of Charges. The customer represents and warrants that the Collateral is, and agrees that the collateral will at all times be, free of any Charge or trust except in favor of CIBC or incurred with CIBC's prior written consent. CIBC may, but will not have to, pay any amount or take any action required to remove or redeem any unauthorized charge. The customer will immediately reimburse CIBC for any amount so paid and will indemnify CIBC in respect of any actions so taken."

[69] The 2000 Credit Agreements each contain the following clause:

> "**Negative Pledge**. There is no lien on any part of your present or future assets, and that you do not assign any right to any income, without our prior consent (which consent will not be unreasonable withheld, except for the four exceptions below, namely,
>
> (a) a Purchase Money Lien;
>
> (b) a Lien existing on an asset when it was acquired;
>
> (c) a renewal or replacement of a Purchase Money Lien or a Lien referred to in (b) above, so long as the principal amount secured by the Lien does not increase; or
>
> (d) a Normal Course Lien".

[70] Section 41 of the **PPSA** states:

> "41(1) A secured party may subordinate, in a security agreement or otherwise, the secured party's security interest to any other interest.
>
> (2) A subordination is effective according to its terms between the parties and may be enforced by a third party if the third party is the person or one of the class of persons for whose benefit the subordination was intended." [Emphasis added.]

[71] In its Final Determination, the Trustee determined that the Debenture (par. 2.2) and the Negative Pledge contained in the 2000 Credit Agreements permit Hickman Equipment to grant Permitted Encumbrances without CIBC's consent and therefore subordinate CIBC's security

interest and excludes from its charge the security interests of persons holding Permitted Encumbrances. In its Final Determination the Trustee defined "Permitted Encumbrances" as follows:

> "Mortgages, liens or other encumbrances on Assets permitted by paragraph 2.2 of the Original Debenture; and Purchase Money Liens, liens existing on an asset when it was acquired, a renewal or replacement of a Purchase Money Lien or of a lien existing on an asset when it was acquired, so long as the principal amount secured by the lien does not increase, or a Normal Course Lien, permitted by Credit Agreements dated April 17, 2000 and June 19, 2000."

[72] It is clear from the wording of s. 41 of the **PPSA** that a secured party may subordinate its security interest to other persons' security interests and that this may be done either in the secured party's own security agreement or in some other manner such as by means of the negative pledges contained in the 2000 Credit Agreements between CIBC and Hickman Equipment. Section 41 likewise removes any requirement there may have been at law for privity of contract to exist between the party claiming the benefit of the subordination and the parties to the original security interest or other document purporting to create the subordination. It is only necessary therefore for the third party claiming the benefit of the subordination to be able to establish that it is one of the class of persons for whose benefit the subordination was intended. It is not the purpose of this particular judgment to make decisions with respect to individual claims by creditors of Hickman Equipment that CIBC had subordinated its security interests under the Debenture or the GSA to them. Those issues will be decided on individual applications by such creditors seeking proceeds from the assets over which they claimed a security interest. The purpose of this judgment is simply to determine whether or not the conclusion of the Trustee in its Final Determination to the effect that the security interest of CIBC under the Debenture and the GSA was subordinated to the interests of the holders of "Permitted Encumbrances" including Unperfected PMSI holders, is correct.

Does the Debenture subordinate CIBC's security interest under it to Permitted Encumbrances?

[73] The concept of "subordination clauses" in Security Agreements between a lender and a borrower being enforceable by third parties was discussed in the decision of the Ontario Court of Appeal in the case **Euroclean Canada Inc. v. Forest Glade Investments Limited et al** (1985), 16 D.L.R. (4th) 289 (Ont.CA.), at p. 297 where the Court held that the following clause in a debenture amounted to a subordination clause which could be enforced by a third party:

> "(e) Not Encumber - The corporation shall not, without the consent in writing of the Holder, create any mortgage, hypothec, charge, lien or other encumbrance upon the mortgaged property or any part thereof ranking or purporting to rank in priority to or pari passu with the charge created by this Debenture except that the corporation may give mortgages or liens in connection with the acquisition of property after the date hereof, or may

> acquire property subject to any mortgage, lien or other encumbrance thereon existing at the time of such acquisition and any such mortgage, lien or other encumbrance shall rank in priority to the charge hereby created."

[74] Additionally, the Ontario Court of Appeal considered another case involving a subordination clause. **In Sperry Inc. v. The Canadian Imperial Bank of Commerce et al** (1985), 17 D.L.R. (4th) 236, the purported subordination clause was contained in a representation and warranty that the collateral was free of any lien, with the exception of purchase money obligations. The Ontario Court of Appeal contrasted the security agreement in **Sperry** with the clear wording in the debenture in **Euroclean** and held that the **Sperry** security fell short of an agreement to subordinate the bank's interest.

[75] In **Greyvest Leasing Inc. v. Canadian Imperial Bank of Commerce** (1993), 5 PPSAC (2nd) 187, the Ontario Court of Appeal considered the same s. 2.2 of the CIBC debenture as is involved in the present case and held that the debenture did not contain a subordination clause. The Court in **Greyvest** did not actually recite in its judgment the s. 2.2 of the CIBC debenture. We only know its wording from a case commentary by one Kenneth C. Morlock who reproduced the wording of the section of the debenture involved in the Greyvest case in a case commentary which he made in relation to **Re Chiips v. Skyview Hotels Ltd. et al** (1994), 116 D.L.R. (4th) 385 (Alta. C.A.). Further reference will be made to Mr. Morlock's case commentary in this judgment.

[76] The **Chiips** decision was relied on by the Trustee in determining that CIBC had subordinated its security interest in the interest of Permitted Encumbrancers. In the Chiips case the Court considered the following debenture provisions;

> "4.05 Possession Use and Release of Mortgaged Property
>
> Until the Security becomes enforceable, the Company may dispose of or deal with the subject matter of the floating charge provided for in Section 4.01(b) hereof in the ordinary course of its business and for the purpose of carrying on the same; provided that the Company shall not, without the prior written consent of the Holder, create, assume or have outstanding, except to the Holder, any mortgage, charge or other encumbrance on any part of the Mortgaged Property ranking or purporting to rank or capable of being enforced in priority to or in pari passu with the Security, other than
>
> (a) any mortgage, lien or other encumbrance upon property created or assumed to secure all or any part of the funds required for the purchase of such property ...
>
> 6.01 The company covenants and agrees with the Holder that, so long as this Debenture is outstanding, the Company shall not:
>
> (c) create or permit any mortgage, charge, lien or other encumbrance

> upon any part or all of the Mortgaged Property ranking or purporting to rank in priority to or pari passu with the Security in order to secure any monies, debts, liabilities, bonds, debentures, notes or other obligations other than this Debenture and the Series of Mortgages and Debentures referred to in Section 8.01(n) hereof which are intended to rank in priority as pari passu with this Debenture; provided, however, that this covenant shall not apply to, nor operate to prevent, and there shall be permitted:
>
> (i) the assuming or giving of purchase money mortgages or other purchase money liens acquired by the Company or the giving of mortgages or liens in connection with the acquisition or purchase of such property or the acquiring of property subject to any mortgage, lien or encumbrance thereof existing at the time of such acquisition, provided that such purchase money mortgages or purchase money liens shall be secured only by the property being acquired by the Company and no other property of the Company ..."

[77] The Alberta Court of Appeal in **Chiips** held that the above provisions amounted to an agreement to subordinate the future PMSI interests whether perfected or not. In Kenneth C. Morlock; **Floating Charges, Negative Pledges, the PPSA and Subordination**; ***Chiips Inc. v. Skyview Hotels Limited*** 10 B.F.L.R 405 at 427, Mr. Morlock noted how the Ontario Court of Appeal came to a different conclusion in **Greyvest** than did the Court of Appeal of Alberta in **Chiips** on the effect of clause 2.2 of the CIBC debenture. He states:

> "The fact that the Ontario Court in *Greyvest* considered that the C.I.B.C. debenture in that case "includes no such provision" is noteworthy because section 2.2 of the C.I.B.C. debenture in *Greyvest* is virtually identically to clause 4.05 of the floating charge debenture in *Chiips*."

In his case review at pp. 414 - 415 Morlock noted how the majority in **Chiips** referred to **Canadian Imperial of Commerce v. International Harvester Credit Corporation of Canada** (1986), 6 P.P.S.A.C. 273 (Ont.C.A.) and **Transamerica Commercial Finance Corp., Canada v. Imperial T.V. & Stereo Centre Ltd.** (1993), 6 P.P.S.A.C. (2nd) 99 (Alta.Q.B.), as authorities for its decision, when neither case actually examined whether the clauses involved were subordination clauses. Morlock contends that in the **International Harvester** decision, the Court assumed that the disputed clause was a subordination clause but held that it did not apply because the trucks at issue formed part of a fixed charge. Similarly, in **Transamerica**, the Court assumed that the clause in question was a subordination clause but held that it did not apply as Transamerica did not fall within the class of intended beneficiaries. In **Chiips**, Harradence, J.A., at p. 390 stated:

> "In construing these clauses it is also very important to look at commercial reality. These clauses are included to allow Skyview to carry on its business. Without such

> clauses, it would be impossible to enter into contracts with suppliers. Suppliers will not ship goods on credit to a company if their security interest is not given priority. An interpretation that rejects these particular clauses as valid subordination clauses does not give business efficacy to the document and completely ignores the commercial reality of transactions of this nature. One must look to the intention of the debenture holders at the time of drafting. The question to be asked is: what did the debenture holders intend when they included this clause? The debenture holders, in including these clauses clearly intended the subordination of their interests in certain situations. It is doubtful they intended that a third party must register under the P.P.S.A. to get priority because this debenture was drafted two years prior to the P.P.S.A. coming into effect. It is recognized that the appellant could have obtained 'super priority' merely by registering a financing statement in a timely fashion. This they did not do, save for the last shipment. Does this mean they should not be able to rely on the subordination clause to obtain priority? Surely not. The debenture holders contemplated and acquiesced to the subordination of their interests to suppliers of Skyview. Commercial reality requires this contemplation to be given effect. Even though the appellant did not obtain "super priority", as they could have, by timely registration, this does not prevent them from relying on the subordination clause in the debenture."

[78] Morlock criticizes this reasoning. At pp. 420 - 421 of his case commentary he states:

> "Such statements are troublesome. They indicate a misunderstanding about important aspects of the PPSA regime because, even if the alleged subordination clauses were not in a security agreement, it would nevertheless be possible for a subsequent credit grantor to obtain priority over a prior secured creditor in either of two situations: first, if the security interest of the subsequent credit grantor qualified as a '*purchase-money* security interest' and the subsequent credit grantor complied with the requirements of the legislation in order to obtain the priority that is obtainable for such security interests; secondly, if there were a written subordination agreement to that effect entered into between the two secured creditors.
>
> ...
>
> Moreover, it should not be overlooked that the 'commercial reality' in *Chiips* was that the furniture supplier, Chiips, was quite prepared to ship goods to Skyview without perfecting its security by registering a financing statement and, apparently, without even making any inquiry to satisfy itself as to the existence of any pre-existing security or subordination clauses in any such pre-existing security even though it would have been relatively easy for it to do so."

[79] CIBC contends that the purported "subordination clauses" in its Debenture and in its Credit Agreements are merely permissive and are not indicative of any intention on the part of CIBC to be subordinated to subsequent creditors. They contend that these clauses merely provide Hickman

Equipment with the right to grant specific charges in the form of purchase money liens. CIBC claims that were it not for these clauses, the exercise of that power by Hickman Equipment would have constituted a breach of the security and put Hickman Equipment into default under the security. CIBC asserts that it does not follow from these clauses that CIBC has agreed to subordinate its security position. Rather CIBC claims that it would be up to the subsequent secured creditors to comply with the purchase money priority requirements of the **PPSA** if they wanted to obtain priority over CIBC's pre-existing security interests. Failing that, they could seek CIBC's execution of a subordination agreement. In support, CIBC cites the closing argument of Morlock in his case commentary at p. 428 where he states:

> "In short, it is submitted that the priority rule set out in the PPSA (apart from those in the subordination section itself) should *prima facie* be found to apply unless the alleged subordination clause is very explicit and clear. The onus should be on the subsequent secured creditor to make out that the subordination clause is explicit and clear."

[80] CIBC submits that the heavy onus suggested by Morlock is justified since no consideration moves from the party seeking the benefit of a purported "subordination" clause. Essentially, the suggestion is that a secured creditor is waiving its priority, without any consideration or even any requirement for notice (in the case of an unperfected interest), which inherently creates a level of uncertainty that is uncharacteristic and undesirable in common commercial practice. In support of this argument CIBC cites **Sun Life Assurance Co. of Canada v. Royal Bank of Canada** (1995), 129 D.L.R. 4305 (Ont. Court of Justice - General Division). In that case the bank gave a credit facility to the debtor and registered a general security agreement in respect thereof. The agreement covered existing and subsequently acquired collateral. At the time, the debtor operated one hotel. Subsequently it built another hotel and the applicant life insurance company gave it a credit facility and registered a general security agreement in respect of that facility. The debtor and the life insurance company intended that the latter should have first priority over the collateral at the second hotel. An employee of the bank was under the impression that the bank had subordinated its security to that of the life insurance company and twice prepared a credit review on that basis. The bank also entered into a commitment letter with the debtor which proceeded on that assumption. When the debtor experienced financial difficulties, the bank took the position that it had priority over the life insurance company. The latter brought the application for an order determining the priorities between the two creditors. The court held that the bank had priority and found that s. 38 of the Ontario **PPSA** provides that a secured party may, in the security agreement or otherwise, subordinate its security interest to any other security interest. The owner of another security interest may take advantage of the subordination even though it is not a party to it. However the Court, in that case, found that there was no subordination agreement between the bank and the debtor. The bank was never requested to subordinate its interests to that of the life insurance company and it did not do so. The commitment letter was given on the erroneous assumption that the bank had given a postponement agreement. In order to take advantage of the right conferred by the section, which was an exception to the registration scheme of the statute, the Court held that the waiver of priority must be clear and unequivocally and made with full knowledge of the circumstances. Since the latter was lacking on the part of the bank, priority should be determined in

accordance with the order of registration. Accordingly, the bank had priority over the life insurance company.

[81] CIBC submits that its Debenture does not contain the explicit and clear language needed to constitute a subordination agreement. It claims that the wording does not go as far as the debenture in the **Chiips** decision and, in particular, does not contain any equivalent section to clause 6.01 of the debenture in the **Chiips** decision. The bank contends that its Debenture does not contain the clear language of subordination which was seen in the **Euroclean** case. CIBC contends rather that its wording is similar to the wording in the **Greyvest** debenture which the Ontario Court of Appeal held it did not constitute a subordination clause.

[82] What exactly did the Court in **Chiips** say with respect to the previously recited alleged subordination clauses referred to in par. [76] hereof. At p. 389 the Court stated:

> "These clauses are not as specific as clauses found in *Euroclean* but they clearly go much further than those found in *Sperry*. Nowhere in *Sperry* do the words 'rank' or 'priority' appear. The clauses now being considered include the terms 'ranking', 'priority' and 'purporting to rank'. In construing the language of the clauses, it is apparent that the debenture holders have at least impliedly granted priority. Both cls. 4.05 and 6.01 set a general rule that there shall be no charges created that rank or purport to rank in priority. The clauses then go on to create an exception. By setting out a rule that nothing shall rank in priority and then drafting an exception, the debenture holders were acknowledging that in this situation, they will subordinate their claim. ..."

Section 2.2 of the Debenture in the case at bar clearly uses the words "ranking", "purporting to rank" and "priority". This is very similar to clause 4.05 in **Chiips**. In the above quote the Court indicates that clause 4.05 creates an exception to the general prohibition against creating charges that rank or purport to rank in priority. Had clause 6.01 not existed in the **Chiips** debenture, the Court could have arrived at the same decision, namely that s. 4.05 of the debenture created an exception to the prohibition against creating charges that rank or purport to rank in priority.

[83] Naturally the parties opposed to CIBC take a different view. Their dispute commences firstly with attempts to rebut the argument of CIBC that clause 2.2 of the Debenture only gives Hickman Equipment the right to grant specific charges in the form of purchase money liens so as to avoid breaches of the Debenture putting Hickman Equipment into default, but not intending in any way to subordinate the security position of CIBC. They cite in support an article by Professor J. Ziegal entitled **The Scope of Section 66(a) of the OPPSA and Effects of Subordination Clause; Euroclean Canada Inc. v. Forest Glade Investments Ltd. (1984), 9 C.D.L.J. 367 at 372**, wherein Ziegal, commenting upon the purported subordination clause in **Euroclean** states:

> "Clause (e) is a familiar provision in floating charge debentures and it serves a double purpose. It rebuts any implication on the one hand that because a debenture holder only has a floating charge it may be superceded by a subsequent fixed

> charge, and on the other it seeks to remove any obstacles the debtor may otherwise encounter in acquiring new collateral for the conduct of his business. Stated more succinctly, cl. (e) is intended to confer priority on purchase money security interest ("PMSI"). That being the case, what difference does it make to the debenture holder whether or not the purchase money security interest has been perfected? Lack of perfection does not prejudice him since he has agreed to the PMSI-holder's priority in advance."

This citation is cited with approval by Houlden, J.A. in the Court of Appeal decision in **Euroclean**.

[84] In addition the parties opposed to CIBC have referred to further comments by Professor Ziegal in **The Ontario Personal Property Security Act Commentary and Analysis, Second Edition**. At p. 322 Professor Ziegal states:

> "Kenneth Morlock has strongly criticized *Chiips* and the earlier cases relied upon by the Alberta Court of Appeal on the ground of the unjustifiable elasticity they give to the meaning of subordination and the uncertainty they create in future applications of s. 38 of the old PPSA. It is certainly true that there is a distinction between a secured creditor *authorizing* a debtor to create a pmsi and agreeing to *subordinate* its security interest to a purchase money financier whether or not the subsequent secured party has met the perfection requirements in the Ontario Act. At the same time, it must be questioned whether the drafters of such clauses mean to draw a conscious distinction between the two aspects. These distinctions only rise to the surface where the debtor has defaulted and the value of the collateral is not sufficient to satisfy the claims of the first secured party and the pmsi financier. But by the same reasoning the PMSI financier cannot complain that it is prejudiced by the a narrow reading of the subordination clauses since in most cases the pmsi financier would not even be aware of the existence of the clause. The equities, therefore, are fairly evenly balanced. Nevertheless, at the end of the day, given the fact that the holder of the general security agreement is generally a sophisticated lender with access to expert legal advise, we support the Chiips construction. Legal counsel, unhappy with the result, can easily change the wording of the security agreement to avoid any inference of an intention to subordinate."

[85] A number of the opposing creditors have cited in support of their position the decision of the Ontario Court of Appeal in **Canadian Imperial Bank of Commerce v. International Harvester Credit Corp. of Canada Ltd.** (1986), 6 PPSAC 273. In that case the Ontario Court of Appeal considered the very same s. 2.2 of the CIBC debenture as exists in the debenture in the case at bar. However the decision of the Court seems to automatically accept that s. 2.2 was a subordination clause and the Court of Appeal did not get into any detailed discussion concerning it because it found that CIBC had not subordinated its interest to International Harvester the subordination provision in a debenture only applied to the floating charge and not to the fixed charge under which the collateral in question was covered. Therefore this case is not of much assistance to me in interpreting clause 2.2. Additionally, the Trial Court decision in this matter,

(1985), 4 PPSAC 329 at par. 21, merely seems to accept that s. 2.2 is a subordination clause and does not enter into any discussion of it. The trial decision, therefore, is similarly less than useful to me determining this issue at the case at bar.

[86] In **Engel Canada Inc. v. TCE Capital Corp.** , (2002) 34 C.B.R. (4th) 169 Wilson, J., of the Ontario Court of Justice, was considering provisions of a General Security Agreement to determine whether they contained a subordination agreement on the part of the secured lender. The case is more applicable to a later consideration which I will apply to the General Security Agreement in place between CIBC and Hickman Equipment and the impact of the Credit Agreements thereon. Nevertheless, at par. 53, the case contains a statement of principle which is equally applicable to the question whether the Debenture subordinates itself to the Permitted Encumbrances. The Court, having recited the previously quoted comments of Harradence, J.A. in **Chiips** (see par. [77] hereof) dealing with commercial reality, the Court then goes on to say:

> "Allowing the purchase of specific encumbered assets without granting priority in the incumbrance appears to be a hollow right that does not make commercial sense unless subordination is implicit."

[87] The respondents cite the **Engel** case as support for the way a Court ought to approach such issues as subordination. In par. 27 Wilson, J., states:

> "First the provisions of the Security Agreement should be canvassed. If there are subordination terms in the agreement, and its terms are clear, that is the end of the inquiry. Second, if there is no subordination term in the governing Security Agreement, or if its terms are unclear or not met, then other documents may be canvassed. Finally, after reviewing all the relevant documents, the applicant is unable to prove subordination on a balance of probabilities, then the evidence of the parties as to their intention or understanding or conduct is admissible or relevant to the inquiry. The factual inquiry may well have to take place in the context of a trial if essential facts are contested. . . The starting point is the governing Security Agreement.

[88] At par. 51, Wilson, J., considering the requirement for specific statements in subordination clauses with respect to priority or rank, states:

> "Schedule A confirms existing exclusions as of the date of the General Security Agreement, as well as future exclusions. It permits "*purchase money liens*, or other *encumbrances created, issued or assumed to secure the unpaid purchase price in respect of such property, or asset*." This clause especially permits and anticipates future encumbrances, although wording with respect to priority or rank is not used.

[89] Wilson, J., then goes on in par. 53 to make the statement which I referred to in par.[86] hereof to the effect that allowing the purchase of specific encumbered assets without granting priority in the encumbrances appears to be a hollow right that does not make commercial sense

unless subordination is implicit.

[90] Respondents in this matter argue that **Engel** stands for the proposition that words dealing with priority or rank are not even necessary for an alleged subordination clause to, in fact, be a subordination agreement. They additionally point to the decision of Rooke, J., of the Alberta Court of Queen's Bench in **Bank of Montreal v. Dynex Petroleum Ltd.** (1997), 46 C.B.R. 3rd at p. 36 in which at par. 68 Rooke, J., after canvassing many of the various decisions referred to earlier in this judgment, states:

> "While there was a great debate in *Chiips* (reference to Chiips citation and that of other cases omitted) ... as to the adequacy of the wording of any purported subordination clause, it being conceded that a vague and non-specific clause is not sufficient (see *Chiips* at par. 49), I believe that no specific "magic, words, such as "rank" or "priority", or any other words are necessary (although they may be helpful) to convey subordination, anymore than the word "trust" is necessary to create a trust. *Chiips* seems to confirm this when, relying upon authorities, I will not repeat, Foisey, J.A., said (par. 30):
>
> > It is interesting to note that it is possible under the [PPSA] to prove a subordination in fact without the existence of a specific subordination agreement ...

[91] Counsel opposed to CIBC have asserted that the use of the words "or otherwise" in s. 41 of the **PPSA** dealing with a secured party subordinating its security, means that the common law rules with respect to extrinsic evidence are no longer applicable to determining whether or not a secured party has agreed to subordinate its security. Under the Parol Evidence Rule, the Court was first obliged to look at the actual agreement itself to determine whether or not the agreement created a subordination. The respondents contend that the words "or otherwise" mean that I can look at all of the extrinsic evidence available in order to assist the Court in determining the intention of CIBC in inserting the purported subordination clause in the Debenture and the negative pledge provisions in the 2000 Credit Agreements which are similarly relied upon by the respondents as constituting an agreement on the part of CIBC to subordinate its security interests to the holders of Permitted Encumbrances. I agree with the respondents who make this assertion. The words "or otherwise" would have no meaning or sense at all if they did not permit the Court to look at something other than the particular Security Agreement in order to determine whether the secured creditor had agreed to subordinate its security to the holders of Permitted Encumbrances.

[92] This means that in construing whether the relevant provision of the Debenture constituted an agreement on the part of CIBC to subordinate its security, I can look at the 2000 Credit Agreements and the "Negative Pledge" provisions thereof to assist in interpreting the Debenture. Similarly, some respondents have suggested that I can look at all of the extrinsic evidence to consider the role that CIBC played in financing Hickman Equipment in order to determine the commercial reality in which CIBC's loans to Hickman Equipment were structured. In that regard, reference has been made to a number of financial statements of Hickman Equipment which were entered in evidence.

Two of these financial statements showed the inventory of Hickman Equipment, e.g. from December 19, 1999 when it was 50 million dollars; and December, 2000, when it was 90 million dollars. During the same period, Hickman's equipment financing went from 31 million dollars to almost 59 million dollars. CIBC, being in receipt of these annual financial statements (as well as monthly internally prepared financial statements), is argued to be very well informed as to the exact manner in which Hickman Equipment was financing its inventory and should be taken to know that third party inventory financing played a much larger financing role in the affairs of Hickman Equipment than did CIBC itself. It is argued that CIBC's role was not inventory financing and that, therefore, it made all the commercial sense in the world for CIBC to agree to postpone its security in favor of those lenders prepared to provide inventory financing to Hickman Equipment.

The 2000 Credit Agreements

[93] Each of the 2000 Credit Agreements contain the following provision:

> "**Negative Pledge:** There is no capital Lien on any of your present or future assets, and that you do not assign any right to any income, without our prior consent (which consent will not be unreasonable (sic) withheld) except for the four exceptions below, namely:
>
> (a) A Purchase Money Lien;
>
> (b) A Lien existing on an asset when it was acquired;
>
> (c) A renewal or replacement of a Purchase Money Lien or a Lien referred to in (b) above so long as the principal amount secured by the Lien does not increase; or
>
> (d) A Normal Course Lien."

[94] The words "Purchase Money Lien", "Lien" and "Normal Course Lien", are not defined in the 2000 Credit Agreements. There is a definition of "Priority Claims" as follows:

> "'Priority Claims' means any amount owing to a creditor that ranks, or may rank, equal to or in priority to our security. These may include unremitted to source deductions and taxes; other amounts owing to governments and governmental bodies; and amounts owing to creditors who may claim priority under the *Bankruptcy and Insolvency Act* or under a Purchase Money Security Interest in inventory or equipment."

[95] In the portion of the 2000 Credit Agreements dealing with the operating line of credit, Priority Claims are deducted from Inventory Value in order to calculate the lending margin or the operating line of credit.

Conclusion on Subordination Issues

[96] I am in wholehearted agreement with the statement of Wilson, J., in **Engel** where it is stated that allowing the purchase of specific encumbered assets without granting priority in the encumbrance appears to be hollow right that does not make commercial sense unless subordination is implicit. I find it impossible to conceive, in light of CIBC's regular receipt of monthly internally prepared financial statements of Hickman Equipment, that CIBC was not aware of the ever-increasing reliance of Hickman Equipment upon third-party inventory financing. In one year, from December 1999 to December 2000, that inventory value almost doubled from 50 million dollars to 90 million dollars. How could any banker, reviewing these financial statements, sincerely believing that it had the right to approve or disapprove of individual cases of third-party financings for Hickman Equipment, not have put a stop to such a rapid expansion in such borrowings. This contention defies commercial reality and has no credibility in the circumstances. I am satisfied that the words " or otherwise" contained in s. 41 of the **PPSA** permit me to consider this extrinsic evidence. The wording of the debenture, s. 2.2 and the Negative Pledge provisions of the 2000 Credit Agreements were the choice of CIBC. Evidence was tendered to the effect that these were standard form clauses. I am satisfied that the Debenture s. 2.2 speaks clearly about ranking and priority and then goes on to permit encumbrances. I am satisfied that the encumbrances permitted by the Debenture are those ranking in priority to the charges of CIBC under the Debenture.

[97] With respect to the negative pledge, contained in the 2000 Credit Agreements, s. (b) thereof clearly permits liens which would exist in priority to the claims of CIBC under its security because it permits liens existing on an asset when it was acquired, i.e. before CIBC's security interest would have fixed on this asset. While the negative pledge section uses the words "Purchase Money Lien" as opposed to the statutory definition of the **PPSA** of "Purchase Money Security Interest", I am satisfied that the intent of the negative pledge was to allow Hickman Equipment to purchase inventory financed by third parties while granting liens thereon in priority to the secured position of CIBC. CIBC's conduct throughout affirms that conclusion. CIBC tendered in evidence in support of its argument that neither the Debenture nor the Credit Agreements created a subordination, some 30 requests made to CIBC for it to acknowledge that it claimed no interest in inventory being financed by other lenders. However, CIBC provided no evidence that it actually attempted to compare the inventory figures of Hickman Equipment with the liability shown on its financial statements in order to determine whether or not other lenders (not seeking approval) were financing Hickman Equipment in its acquisition of inventory. Jennifer Lee, on behalf of CIBC, testified both by way of affidavit and *viva voce* that CIBC took the position that its various security documents gave it a first secured position unless it specifically agreed to subordinate itself to other lenders. Such a contention is not credible in light of the very large sums of money that CIBC must have been aware were being provided by third party lenders on the security of inventory. It is simply not reasonable to assume that these third party lenders were making such advances upon second ranking security as was contended by CIBC. I therefore conclude that both the Debenture and the 2000 Credit Agreements permitted third party lenders to become holders of Permitted Encumbrances in priority to the security held by CIBC over the inventory by way of its Debenture and its GSA.

[98] In summary, therefore, I find:

(1) that the Supplemental Debentures have been properly transitioned pursuant to the **PPSA** as more particularly set out in par. [42] hereof;

(2) that the **Bank Act** security is invalid and unenforceable as against the creditors of Hickman Equipment;

(3) that the GSA is valid and enforceable and was not explicitly or implicitly released or discharged by CIBC; and

(4) that both the Debenture and the 2000 Credit Agreements permit the granting by Hickman Equipment to the holders of Permitted Encumbrances of security interests in priority to the security interests in inventory held by CIBC pursuant to the Debenture and its GSA.

Costs

[99] Costs are awarded to the following creditors who opposed the appeal of CIBC, namely John Deere Limited and John Deere Credit Inc., CIT Financial Ltd., ABN-AMRO, Royal Bank of Canad, Tramac Equipment Finance Inc. and Cedar Rapids Inc.

Justice

Thomas Kendell, Q.C. and Stacey Power for General Motors Acceptance Corporation.
Michael Harrington, Q.C. and Maureen Ryan, for John Deere Limited and John Deere Credit Inc.
Gregory Smith and Brian Windsor for ABN-AMRO, Royal Bank of Canada, Cedar Rapids Inc. and Tramac Equipment Finance Limited.
Gregory Dickie and Kerry Hatfield for CIT Financial.
Geoffrey Spencer and Kim Keeping for Canadian Imperial Bank of Commerce.
Francoise Belzil for Cedarapids Inc.
Jeffrey Rosekat for Ingersall Rand Inc.