SUMMARY OF CURRENT DOCUMENT	
Name of Issuing Party or Person:	**John Deere Limited and John Deere Credit Inc.**
Date of Document:	**7 February 2003**
Summary of Order/Relief Sought or Statement of Purpose in filing:	**Memorandum of Authorities of John Deere Limited and John Deere Credit Inc. in support of various Reply Memoranda of Fact and Law of John Deere Limited and John Deere Credit Inc., in respect of various appeals and by and respect of Canadian Imperial Bank of Commerce, GMAC, ABN-AMRO Bank N.V., Canada Branch, Bombardier Capital Leasing Ltd., Contract Funding Group Inc., Culease Financial Services, Royal Bank of Canada, MTC Leasing Inc., Wells Fargo Equipment Finance Company and TD Asset Finance Corp.**
Court Sub-File Numbers:	**7: 05, 7:24, 7:25, 7:26, 7:27, 7:33, 7:33A, 7:34, 7:36, 7:37, 7:38, 7:39, 7:42, 7:43, 7:45, 7:47, 7:48, 7:49, 7:50**

2002 01T 0352

IN THE SUPREME COURT OF NEWFOUNDLAND AND LABRADOR

IN THE MATTER OF a Court ordered receivership of Hickman Equipment (1985) Limited ("Hickman Equipment") pursuant to Rule 25 of the ***Rules of the Supreme Court, 1986*** under the ***Judicature Act***, RSNL 1990, c. J-4, as amended.

AND IN THE MATTER OF the ***Bankruptcy and Insolvency Act***, RSC 1985, c. B-3, as amended.

MEMORANDUM OF AUTHORITIES OF JOHN DEERE LIMITED AND JOHN DEERE CREDIT INC. (VOLUME II)

Michael F. Harrington, Q.C.
STEWART MCKELVEY STIRLING SCALES
Suite 1100, 100 New Gower Street
P.O. Box 5038
St. John's, NF A1C 5V3
Solicitors for John Deere Limited and John Deere Credit Inc.

MEMORANDUM OF AUTHORITIES OF
JOHN DEERE LIMITED AND JOHN DEERE CREDIT INC.

STATUTES AND REGULATIONS:	**TAB NUMBER**
Bank Act, S.C. 1991, c. 46	1
Bills of Sale Act, R.S.N.L. 1990, c. B-3, as amended	2
Conditional Sales Act, R.S.N.L. 1990, c. C-28, as amended	3
Personal Property Security Act, S.N.L. 1998, c. P-7.1	4
Personal Property Security Regulations, Nfld. Reg. 103/199	5
TEXTS AND OTHER SECONDARY MATERIALS:	
Chitty on Contracts, Vol. 1, 27th ed. (London: Sweet & Maxwell, 1994)	6
Crawford and Falconbridge, **Banking and Bills of Exchange**, Vol. 2, 8th ed. (Aurora:Canada Law Book Inc., 1986)	7
Fridman, G.H.L., **The Law of Contract in Canada**, 3rd ed. (Toronto: Carswell, 1994)	8
Ogilvie, M.H., **Banking Law of Canada**, 2nd ed. (Toronto: Carswell, 1998)	9
The Shorter Oxford English Dictionary, Vol. 1, 3rd ed. (Oxford: Clareneden Press)	10
Walsh, Catherine, **An Introduction to the New Brunswick Personal Property Security Act** (Fredericton: New Bruswick Geographic Information Corporation, 1995)	11

CASES:

Act does not apply to convictions incurred outside the Province of Saskatchewan prior to November 1, 1983, the date the relevant provisions of the said Act came into force, where there has been no conviction in Saskatchewan.

It becomes unnecessary for me to reach a conclusion on the retrospective effect of any of the provisions of the new Act, but I am indebted to counsel for their extensive briefs on the subject. In particular, I make no finding whether s. 162 is triggered by offences committed in Saskatchewan prior to November 1, 1983, nor do I make any finding whether convictions incurred prior to that date can be taken into account for the purpose of increasing the length of suspension.

If they wish, counsel may speak to me on the matter of costs.

Judgment accordingly.

RE CANADIAN IMPERIAL BANK OF COMMERCE AND 281787 ALBERTA LTD. et al.

Alberta Court of Appeal, Moir, Belzil and Stevenson JJ.A. May 29, 1984.

Debtor and creditor — Priorities — Bank taking s. 178 security and subsequently registering notice — Whether it has priority over claim of landlord for unpaid rent — Bank Act, 1980-81-82-83 (Can.), c. 40, s. 178(4)(a).

The first respondent gave a promise to give security, security and a notice of intention to give the appellant bank security under s. 178 of the *Bank Act*, 1980-81-82-83 (Can.), c. 40, on April 1, 1982, and the bank registered the notice on April 8th. The first respondent became a tenant of the second respondent and upon default the latter directed seizure of the tenant's assets. They were sold and the proceeds held pending an application to determine priorities between the bank and the landlord. On the application it was held by the master that the appellant had priority, but that judgment was reversed on appeal. On further appeal, **held**, the appeal should be dismissed.

Section 178(4)(*a*) of the Act provides that the bank's rights as against creditors of the person giving the security are void unless a notice of intention signed by the debtor giving the security was registered not more than three years before the security was given. Registration after security has been given does not comply with this requirement. The bank therefore lost its priority against the landlord.

Cases referred to

Re Buschman and Leoville Savings & Credit Union Ltd. et al. (1970), 13 D.L.R. (3d) 240, 75 W.W.R. 66 *sub nom. Leoville Savings & Credit Union Ltd. v. Campagna, Royal Bank of Canada et al.*; *Bank of Nova Scotia v. McLaughlin* (1980), 28 N.B.R. (2d) 688

Statutes referred to

Bank Act, 1980-81-82-83 (Can.), c. 40, ss. 178, 179, 180

APPEAL from a judgment of Quigley J., holding that the appellant bank did not have priority over the assets of the first respondent.

N. T. DeMeza, for appellant.
S. T. H. O'Neil, for respondent, Richfield Properties Ltd.
No one appearing for other respondent.
C. P. Lee, for other creditors.

The judgment of the court was delivered by

STEVENSON J.A.:—The appellant bank appeals an order declaring that s. 178 security taken by it from the respondent numbered company (carrying on business as "Crockett's") is void as against the respondent Richfield (and other creditors of Crockett's). The question arose when Richfield, as an unpaid landlord, instructed seizure of the assets of Crockett's and the issue is whether the bank's security is void against Richfield and other creditors because it registered its notice of intention to take that security after the security had in fact been given.

On April 1, 1982, Crockett's signed a series of documents in favour of the bank: a written promise to give security under s. 178 of the *Bank Act*, 1980-81-82-83 (Can.), c. 40, s. 178 security, and a notice of intention to give that security. The notice was registered on April 8, 1982, and advances were made on the security. Crockett's became a tenant of Richfield and when it defaulted in its rental obligation Richfield instructed seizure. The bank claimed priority over Richfield and, by order, the assets were sold and the proceeds held pending determination of this question. There was a dispute about the validity of Richfield's seizure and questions about priorities of the parties. The case was argued before us on the basis that Richfield is an ordinary creditor, but as such, takes priority by reason of the invalidity of the security. The question was first heard by the master who decided in favour of the bank, but on appeal the chambers judge held that the bank had failed to comply with the Act and thus lost its priority. For the purposes of these proceedings it is conceded that the bank's security would be valid and take priority but for the effect of s. 178(4)(*a*) of the *Bank Act* upon which Richfield relies.

The bank took its security under s. 178(1)(*a*) of the *Bank Act*:

> 178(1) A bank may lend money and make advances,
>
> (*a*) to any wholesale or retail purchaser or shipper of, or dealer in . . . wares and merchandise . . .

. . . . .

and the security may be given by signature and delivery to the bank by or on behalf of the person giving the security of a document in the form set out in the appropriate schedule or in a form to the like effect.

It then gains the rights provided by s. 178(2):

178(2) Delivery of a document giving security on property to a bank under the authority of this section vests in the bank in respect of the property therein described

. . . . .

(*c*) . . . the same rights and powers as if the bank had acquired a warehouse receipt or bill of lading in which such property was described,

and then by s. 179(1):

179(1) All the rights and powers of a bank in respect of the property mentioned in or covered by a warehouse receipt of bill of lading acquired and held by the bank, and those rights and powers of the bank in respect of the property covered by a security given to the bank under section 178 that are the same as if the bank had acquired a warehouse receipt or bill of lading in which such property was described, have, subject to subsection 178(4) and subsections (2) and (3) of this section, priority over all rights subsequently acquired in, on or in respect of such property, and also over the claim of any unpaid vendor . . .

Richfield relies on s. 178(4)(*a*):

178(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 of 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*;

(Emphasis added.)

The bank interprets s. 178(4)(*a*) as meaning that it loses its priority for so long as its notice is unregistered but upon registration it takes priority. That interpretation, it says, would serve the object of the section which is to prevent the establishment of secret liens. On the other hand, Richfield relies on the plain wording of s. 178(4)(*a*).

While we were referred to two authorities: *Re Buschman and Leoville Savings & Credit Union Ltd. et al.* (1970), 13 D.L.R. (3d) 240, 75 W.W.R. 66 *sub nom. Leoville Savings & Credit Union Ltd. v. Campagna, Royal Bank of Canada et al.*, and *Bank of Nova Scotia v. McLaughlin* (1980), 28 N.B.R. (2d) 688, this issue was not raised in either case. There are therefore no authorities on the interpretation of the section.

Counsel do not suggest any self-evident support for one interpretation over the other. The bank says that the section should not be interpreted literally, but should be read as merely establishing an antecedent deadline for the filing of the security.

Looking at the provision in the context of the other surrounding provisions I am of the view that the literal interpretation is consistent with the other provisions of the Act. The bank's contention, on the other hand, requires us to read words into some provisions of the statute. If we look at s. 178(4)(*a*), the bank's position requires us to read that provision as extending not only "unless", but also "until". Section 179(1) gives priority over rights subsequently acquired in or in respect of the property: and that is subsequent to the granting of the security, not subsequent to registration. There are other sections which indicate that the Act does not contemplate subsequent perfection of the security. For example, s. 180(1)(*a*) contemplates the loan and the acquisition of the security as being contemporaneous. Section 179(2) contemplates immediate vesting. Section 179(3) contemplates rights to enforce the security. None of these are conditioned on registration. The security is either valid when taken, or not. In short, I see no reason for departing from the plain terms of the section.

I would dismiss the appeal, with costs.

Appeal dismissed

[END OF VOLUME]

CANADIAN IMPERIAL BANK OF COMMERCE v. INTERNATIONAL HARVESTER CREDIT CORPORATION OF CANADA LTD.

Ontario Supreme Court [Court of Appeal],
Brooke, Lacourcière and Robins JJ.A.

Heard—November 25, 1986.
Judgment—December 18, 1986.

Priorities — Competing perfected interests — General rule — Application brought to determine priority between fixed and floating charge debenture and conditional sales agreement — Subordination clause contained in debenture limited to floating charge which did not cover chattels — Not applicable — Priority to bank — Personal Property Security Act, R.S.O. 1980, c. 375, s. 35.

IHCC leased nine trucks and a trailer to the debtor company, P Ltd. IHCC perfected its security interest in the leased vehicles by registering financing statements pursuant to the provisions of the Personal Property Security Act. Subsequently P Ltd. executed a fixed and floating charge debenture in favour of the Bank. That debenture created a fixed charge on the trucks and trailer leased by IHCC to P Ltd. The debenture was registered under both the Corporation Securities Registration Act (CSRA) and the Personal Property Security Act on the same day. A subordination clause in the debenture granted to P Ltd. the right to deal with the collateral in the ordinary course of business.

P Ltd decided to purchase the nine trucks pursuant to a purchase option contained in the lease agreements with IHCC. Because IHCC did not have a licence to sell the trucks, the sale was completed through a third party, M Ltd. To effect the sale, IHCC conveyed the trucks to M Ltd. and M Ltd. then entered into a conditional sales contract from P Ltd. The conditional sales contract was then assigned by M Ltd. to IHCC. IHCC also had a conditional sales contract from P Ltd. that was guaranteed by M Ltd. IHCC then registered financing statements pursuant to the Personal Property Security Act with respect to the conditional sales contracts.

The vehicles were sold pursuant to a court order and both the Bank and IHCC claimed priority to the proceeds of the sale. At trial it was found that IHCC had a perfected security interest in the trailer and was entitled to the proceeds of the trailer sale. It was also found at trial that the Bank's debenture contained a subordination clause which could benefit IHCC and entitled it to priority to the nine vehicles. The Bank appealed claiming priority to the nine vehicles by prior registration of the debenture which did not contain a subordination clause and claiming that the amount of the proceeds on the sale of the vehicle should only be paid to IHCC to the extent of the debt owed on the trailer.

Held—The appeal was allowed.

The nine trucks were part of the fixed charge. The subordination clause in the debenture was limited to the floating charge which, it was conceded, did not apply to the trucks. The priority belonged to the Bank.

IHCC had priority to the trailer and that was not an issue in the appeal. The amount due to IHCC was less then the amount achieved on the sale of the collateral. The Act in s. 59 limited the claim of IHCC to the indebtedness on the trailer. Therefore, IHCC's priority over the Bank was restricted to that amount with the excess on realization being part of the funds owed to the Bank under the debenture.

Cases considered
Indemnity Ins. Co. of North America v. Excel Cleaning Services, [1954] S.C.R. 169, [1954] 2 D.L.R. 721, [1954] I.L.R. 1-143 – applied.
Toronto (City) v. W.H. Hotel Ltd., [1966] S.C.R. 434, 56 D.L.R. (2d) 539 – applied.

Statutes considered
Corporation Securities Registration Act, R.S.O. 1970, c. 88.
Personal Property Security Act, R.S.O. 1970, c. 344, ss. 39, 58.

Canadian Abridgment (2nd) Classification
Corporations X. 2. 4.
Personal Property IV. 1. a.

APPEAL from decision of Rosenberg J., reported at 4 P.P.S.A.C. 329, to interpret debenture and determine priorities.

J. Sopinka, Q.C., and *D.B. Houston*, for appellant.
W. Dunlop, for respondent.

December 18, 1986. The judgment of the Court was delivered by

BROOKE J.A.:—At the conclusion of the argument, we reserved judgment to give further consideration to the clauses in the debenture from Prospect Paving Limited ("Prospect") to the Canadian Imperial Bank of Commerce (the "Bank") which the trial Judge correctly found determined the priority between the parties to this action [reported at 4 P.P.S.A.C. 329]. The facts are carefully set out in the judgment in appeal and need not be repeated in full here. For our purposes, it is sufficient to say that on the 17th of October 1980 Prospect executed a fixed and floating charge debenture in favour of the Bank. The debenture contained the following clauses:

> "2.1 As security for the due payment of all moneys payable hereunder, the Corporation as beneficial owner hereby:
>
> (a) grants, assigns, conveys, mortgages and charges as and by way of a first fixed and specific mortgage and charge to and in favour of the Bank, its successors and assigns all machinery, equipment, plant, vehicles, goods and chattels now owned by the Corporation and described or referred to in Schedule A hereto and all other machinery, equipment, plant, vehicles, goods and chattels, hereafter acquired by the Corporation; and
>
> (b) charges as and by way of a first floating charge to and in favour 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 including, without limitation, its franchises.
>
> In this Debenture, the mortgages and charges hereby constituted are

called the 'Security' and the subject matter of the Security is called the 'Charged Premises'

2.2 Until the Security becomes enforceable, the Corporation 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 Corporation 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 indebtedness secured thereby is not increased, or any inchoate liens for taxes or assessments by public authorities."

A fleet of nine trucks of which Prospect was the lessee were included in Sched. A and were the subject of the fixed charge.

On the 5th of November 1980 the Bank registered the debenture under the provisions of the Corporation Securities Registration Act, R.S.O. 1970, c. 88 (now R.S.O. 1980, c. 94). On the same day, the Bank filed a financing statement under the provisions of the Personal Property Security Act, R.S.O. 1970, c. 344 (now R.S.O. 1980, c. 375).

On the 27th of February 1981 the owner of the nine trucks conveyed each of them to Prospect under a conditional sales contract which contract was assigned to International Harvester Credit Corporation of Canada Limited ("International"). International filed financing statements in connection with the conditional sales contract on the 17th of March 1981.

Rosenberg J. held that in the circumstances the Bank was the secured party. He referred to s. 39 of the Personal Property Security Act which says:

"39. A secured party may, in the security agreement or otherwise, subordinate his security interest to any other security interest."

He held that by reason of ss. 2.1 and 2.2 of the debenture, the Bank had subordinated its security to International. He said [p. 336, 4 P.P.S.A.C.]:

"Subordination provisions are generally associated with and are arguably implicit in floating charges. However, there is no reason in principle if the language of the security so provides why a subor-

dination provision cannot also apply to a fixed charge. Section 2.2 of the debenture extends the subordination provision to the trucks in question. The provision relates to the creation of a limited form of mortgage charge or other encumbrance 'on any part of the charged premises'. Since the charged premises include all the security under the fixed charge as well as the floating charge, the proviso must relate to the fixed charge as well."

With the greatest respect, I do not agree. In my opinion, the subordination provision in the debenture does not apply to the nine trucks as they form part of the fixed charged. I think the subordination clause is limited to the floating charge which, it is conceded, did not apply to the trucks. While the drafting of the clauses leaves much to be desired, I think that it makes provision only as to the manner of the floating charge until it becomes enforceable. For that period of time it provides that Prospect can deal with the subject matter of the floating charge in the ordinary course of its business provided that it cannot encumber any part of that property except where necessary to finance the purchase of its property and then only to the extent provided for in the clause. In my opinion, this interpretation gives business efficacy to the document: *Toronto (City) v. W.H. Hotel Ltd.* [1966] S.C.R. 434, 56 D.L.R. (2d) 539, and *Indemnity Ins. Co. of North America v. Excel Cleaning Service*, [1954] S.C.R. 169, [1954] 2 D.L.R. 721, [1954] I.L.R. 1-143.

The second issue in the appeal has to do with a trailer. Because the facts are different in this instance, the priority of International is not in issue. The issue is the amount due to International. The amount owing by Prospect to International on account of the trailer was $16,000. The trustee sold the trailer for $23,000 and the trial Judge held that the full amount should be paid to International. The disposition of the proceeds of such a sale is provided for by s. 58 (now s. 59 R.S.O. 1980, c. 375) of the Personal Property Security Act. In my view, the trial Judge erred in his conclusion that International was entitled to anything more than Prospect's indebtedness to it of $16,000. This was the amount that was required to satisfy International's obligation secured by its security interest.

In the result then, I would allow the appeal and set aside the judgment of Rosenberg J. and substitute therefore an order that all but $16,000 of the funds in the special account and accrued interest thereon are to be paid to the appellant. There will be no order as to costs in this Court. I reach this conclusion because, in my view, the drafting of the document by the appellant was the cause of this litigation. The appellant is entitled to the costs of the trial and of any preliminary motions.

Appeal allowed.

[1987] 5 W.W.R. 236, 7 P.P.S.A.C. 230, 57 Sask. R. 88, 40 D.L.R. (4th) 326

1987 CarswellSask 358

Canadian Imperial Bank of Commerce v. Marathon Realty Co.

CANADIAN IMPERIAL BANK OF COMMERCE v. MARATHON REALTY COMPANY LIMITED

Saskatchewan Court of Appeal

Tallis, Cameron and Wakeling JJ.A.

Judgment: June 9, 1987

Docket: No. 9133

Counsel: A. Logue, for appellant.

B. Salte, for respondent.

Subject: Insolvency; Property; Corporate and Commercial

Personal Property Security --- Attachment of security interest -- Special rules -- Proceeds.

Personal Property Security --- Priority of security interest -- Purchase money security interest.

Personal Property Security --- Priority of security interest -- Security interests versus other interests -- Under provincial law -- Lien, charge or other interest given by statute or rule of law -- Distress for rent.

Personal property security -- Security interests under Personal Property Security Acts -- Priorities -- Landlord distraining against inventory subject to bank's security interest covering inventory and proceeds -- Saskatchewan Landlord and Tenant Act, s. 25, including proceeds under purchase-money security interest -- Bank not losing its security interest by failing to require debtor to pay proceeds as soon as received on sale of inventory -- Uncontradicted affidavit evidence establishing that inventory purchased with money advanced by bank -- Landlord's claim subordinated to bank's purchase money security interest.

Personal property security -- Security interests under Personal Property Security Acts -- Subject matter -- Proceeds -- Bank holding perfected security interests in debtor's inventory and proceeds -- Debtor using proceeds to purchase further inventory -- Bank's security extending to replacement inventory as proceeds of proceeds.

Landlord and tenant -- Distress -- Priorities -- Landlord distraining against inventory subject to bank's security interest covering inventory and proceeds -- Saskatchewan Landlord and Tenant Act, s. 25, including proceeds under purchase-money security interest -- Bank not losing its security interest by failing to require debtor to pay proceeds as received on sale of inventory -- Uncontradicted affidavit evidence establishing that inventory purchased with money advanced by bank -- Landlord's claim subordinated to bank's purchase money security interest.

The corporate debtor executed a general security agreement in favour of the applicant bank. The agreement granted the bank a security interest in all the debtor's assets and inventory and all proceeds derived directly or indirectly from any dealing with the collateral, and also provided that all proceeds of sale should be paid to the bank. The respondent, which was the debtor's landlord, subsequently seized the debtor's inventory for rental arrears. The bank sought a declaration of priority under its security agreement. In support of its application the bank filed an affidavit of the debtor's owner deposing that all the inventory resulted from moneys advanced by the bank subsequent to execution of the security agreement through direct financing or through proceeds obtained from sales of prior inventory. This affidavit was unopposed. The application was dismissed and the bank appealed.

Held:

Appeal allowed.

Under the Saskatchewan Personal Property Security Act, a security interest continues in property acquired by the proceeds arising from secured collateral. Section 28 of the Act provides that the interest extends to the proceeds, which are defined in s. 2(ee) as including property arising from dealing with proceeds.

Section 25 of the Landlord and Tenant Act does not exclude proceeds from the concept of purchase-money security interest. The section was designed to resolve priority conflicts between a landlord's lien arising by operation of law and a competing security interest in the same property. The concept of a purchase-money security interest in s. 25 does not differ from that under the Personal Property Security Act, and under s. 25 a landlord's claim is now subordinated in certain defined circumstances to a purchase-money security interest.

Further, the bank did not lose its security interest in the inventory proceeds by not insisting that the debtor immediately pay over all sale proceeds as required by the security agreement. A security holder need not strictly enforce each contractual term under the security agreement in order to avoid losing its security interest. The purpose of the Personal Property Security Act is to simplify the law and bring it up to date with commercial practices. As well, the Act does not require creditors to strictly police the activities of its borrowers once a perfected security interest over inventory and proceeds is established.

Finally, the affidavit of the owner was properly admissible in this case. The affidavit provided uncontradicted evidence that the bank advanced money in order for the debtor to acquire rights in the property under seizure and that the money was so applied.

Cases considered:

Chrysler Credit Can. Ltd. v. Royal Bank, [1986] 6 W.W.R. 338, 6 P.P.S.A.C. 153, 30 D.L.R. (4th) 616, 50 Sask. R. 216 (C.A.) -- considered

Dube v. Bank of Montreal (1986), 5 P.P.S.A.C. 269, 27 D.L.R. (4th) 718, 45 Sask. R. 291 (C.A.) [leave to appeal to S.C.C. refused 27 D.L.R. (4th) 718n, 67 N.R. 160] -- considered

Prince Albert Credit Union v. Cudworth Farm Equip. Ltd. (1985), 61 C.B.R. (N.S.) 49, 5 P.P.S.A.C. 116, 45 Sask. R. 67 (Q.B.) -- applied

Statutes considered:

Labour Standards Act, R.S.S. 1978, c. L-1

s. 56(1) [re-en. 1980-81, c. 63, s. 5]

Landlord and Tenant Act, R.S.S. 1978, c. L-6

s. 25 [am. 1979-80, c. 28, ss. 3, 4; 1982-83, c. 16, s. 31]

Personal Property Security Act, S.S. 1979-80, c. P-6.1

s. 2(ee), (gg)(i), (ii)

s. 28(1)

s. 34(2)

Authorities considered:

Annotation, C.I.B.C. v. Marathon Realty Co., 6 P.P.S.A.C. 67.

Annotation, Dube v. Bank of Montreal, 5 P.P.S.A.C. 275.1, pp. 275.1-75.3.

Appeal from judgment, 6 P.P.S.A.C. 65, 47 Sask. R. 237, dismissing application by holder of general security agreement for declaration of priority in debtor's inventory.

The judgment of the court was delivered by *Tallis J.A.*:

1 This appeal, involving s. 25 of the Landlord and Tenant Act, R.S.S. 1978, c. L-6 [amended 1979-80, c. 28], and ss. 2 (*ee*) and 28(1) of the Personal Property Security Act, S.S. 1979-80, c. P-6.1, arises from a declaration in favour of the respondent landlord (Marathon) that its claim for past due rent takes priority to the security interest of the appellant bank in the lessee's personal property.

2 In this case, we must consider the scope and applicability of the relevant statutory provisions. Section 25 of the Landlord and Tenant Act reads, in relevant part:

25. -- (1) In this section:

(*a*) "purchase-money security interest" means:

(ii) *a security interest that is taken by a person who gives value for the purpose of enabling the debtor to acquire rights in or to personal property, to the extent that the value is applied to acquire such rights.*

(*b*) "security agreement" means an agreement that creates or provides for a security interest;

(*c*) "security interest" means an interest in goods that secures payment or performance of an obligation.

(1.1.) No landlord shall distrain for rent on the goods and chattels of any person except the tenant or person who is liable for the rent, even though the goods or chattels are bound on the premises.

(2) Subsection (1.1) does not apply:

(*b*) in favour of a person whose title is derived by purchase, gift, transfer or assignment from the tenant, whether absolute or in trust, or by way of a security agreement, *other than a security agreement creating a purchase-money security interest, or otherwise*:

(3) In this section "tenant" means a person holding directly of the landlord. [emphasis added]

3 Sections 2(*ee*) and 28(1) of the Personal Property Security Act read:

2. In this Act:

(*ee*) "proceeds" means identifiable or traceable personal property in any form or fixtures derived directly or indirectly from any dealing with the collateral or proceeds therefrom, and includes insurance payments or any other payments as indemnity or compensation for loss of or damage to the collateral or proceeds therefrom, or any right to such payment, and any payment made in total or partial discharge of an intangible, chattel paper, instrument or security; and money, cheques and deposit accounts in banks, credit unions, trust companies or similar institutions are cash proceeds and all other proceeds are non-cash proceeds.

28. -- (1) Subject to the other provisions of this Act, where collateral is dealt with or otherwise gives rise to proceeds, the security interest therein:

(*a*) continues as to the collateral unless the secured party expressly or impliedly authorizes such dealing; and

(*b*) extends to the proceeds.

4 The basic issue on this appeal is the priority between the contractual and statutory claims asserted by the respondent landlord on the inventory of its tenant, a retailer, in the leased premises, and the claim of the appellant bank who had, under a written agreement, loaned the tenant retailer the necessary funds to acquire its original inventory and, prior to the landlord's levy under the warrant of distress, had perfected a security interest in the inventory and proceeds. In order to pass upon this basic issue, we must answer a threshold question -- whether the bank's security interest in the original inventory extends to proceeds from its sale, and also includes the replacement inventory as *proceeds of proceeds*.

5 The issue, although narrow, cannot be determined except against a factual background. On 12th April 1982 the tenant retailer "Kiddies" entered into a written lease for premises in Gateway North Plaza, Prince Albert, Saskatchewan. Marathon purchased the property in 1984 and became Kiddies' landlord. In reasons now reported [6 P.P.S.A.C. 65 at 68-69, 47 Sask. R. 237] the learned chambers judge sums up the business relationship between the appellant bank and the tenant retailer (Kiddies):

On May 15, 1983 the debtor executed a general security agreement in favour of the bank. It was stated therein that the debtor granted a security interest to the bank in all of the kinds of property described which the debtor then owned or might thereafter acquire. A standard list of various types of personal property was included. Under the heading of "Supplementary Description of Inventory" the following was set out:

All the clothing, children's wear, shoes, goods, wares and merchandise and all other items held as inventory.

The bank registered a financing statement on May 12, 1983 claiming a security interest in "all the assets of the company now owned or hereafter acquired including all clothing, children's wear, shoes, goods, wares and merchandise". The bank claimed a purchase-money security interest and also asserted a claim to the proceeds from the described collateral. A registration life of 15 years was selected.

The bank clearly possessed a perfected security interest in all of the personal property of the debtor. The debtor and the bank no doubt intended that the bank should also possess a purchase-money security interests in the inventory -- this intention has not been disputed. The present indebtedness of the debtor to the bank in the amount of $53,170.74 is also not disputed. But the question which must be resolved is whether the bank did, in fact, possess a purchase- money security interest in the inventory of the debtor which was seized by Marathon on February 14, 1986.

6 The general security agreement between the parties contained the following, inter alia, provisions:

3.01 Inventory All goods now or hereafter forming part of the inventory of the undersigned including, without limiting the generality of the foregoing, the following: goods held for sale or lease; goods furnished or to be furnished under contracts of service; goods which are raw materials or work in process; goods used in or procured for packing; materials used or consumed in the business of the undersigned; emblements, industrial growing crops, oil, gas and other minerals to be extracted; timber to be cut; and the goods described in paragraph 15 hereof ...

3.08 Proceeds All personal property in any form or fixtures derived directly or indirectly from any dealing with the Collateral or that indemnifies or compensates for Collateral destroyed or damaged ...

7. Until default as hereinafter defined, the undersigned may, subject tothe provisions of paragraph 10 hereof, use the Collateral in any lawful manner not inconsistent with this agreement or with the terms or conditions or any policy of insurance thereon, and sell the same ordinary course of business. All proceeds of sale shall be received as trustee for the Bank and shall be forthwith paid over to the Bank.

13. The Bank may grant extensions of time and other indulgences, take and give up securities, accept compositions, grant releases and discharges and otherwise deal with the undersigned, debtors of the undersigned, sureties and others and with the Collateral and other securities as the Bank may see fit without prejudice to the liability of the undersigned or the Bank's right to hold and realize this security.

7 On 14th February 1986 Marathon seized Kiddies' inventory for rental arrears of $32,351.10. On that day Kiddies owed $53,170.74 to the appellant bank under the terms of the general security agreement.

8 At the outset, we observe that the entire relevant evidence is documentary or in the form of unchallenged evidence. Since the contents of the affidavit of Terry Taczlikowicz were stressed in argument before us, we quote the following

paragraphs from her affidavit:

I, TERRY TACZLIKOWICZ, of the City of Prince Albert, in the Province of Saskatchewan, Businesswoman, HEREBY MAKE OATH AND SAY AS FOLLOWS:

1. THAT I am the owner-manager of Kiddies Korner Clothiers Ltd., and as such have personal knowledge of the matters hereinafter deposed to except where stated to be based on information and belief and where so stated I verily believe the same to be true.

2. THAT on February 14th, 1986 agents of Marathon Realty Company Limited purported to distrain the inventory of Kiddies Korner Clothiers Ltd., the Company of which I am owner-manager, and in fact removed that inventory from the premises where I carry on business located in The Gateway North Plaza, Prince Albert, Saskatchewan.

3. THAT in May of 1983 I executed an agreement pledging as security to the Canadian Imperial Bank of Commerce, inter alia, all goods forming the inventory of Kiddies Korner Clothiers Ltd., such agreement being annexed hereto and marked as Exhibit "A" to this my Affidavit.

4. THAT the purpose for executing Exhibit "A" was to be able to borrow money which was used to acquire inventory.

5. THAT subsequent to the execution of Exhibit "A", the Canadian Imperial Bank of Commerce advanced funds to me from time to time, which were used for the acquisition of inventory, for purposes of retail sale in my business.

6. THAT all inventory currently possessed by Kiddies Korner Clothiers Ltd., which is distrained by Marathon Realty Company Limited results from the monies which have been advanced to me by the Canadian Imperial Bank of Commerce, subsequent to the execution of Exhibit "A".

7. THAT I have not injected into the business any personal or outside funds whatsoever, by way of loan, or otherwise, and the inventory as it now exists has been obtained through direct financing from the Canadian Imperial Bank of Commerce subsequent to the execution of Exhibit "A", and through proceeds obtained from that inventory's sales subsequent to the execution of Exhibit "A".

8. THAT Kiddies Korner Clothiers Ltd. is currently indebted to the Canadian Imperial Bank of Commerce in the amount of Fifty Three Thousand One Hundred Seventy Dollars and Seventy-Four Cents ($53,170.74).

9 The learned chambers judge, who held that the appellant's security interest did not prevail over the landlord's claim, said at pp. 69-70:

It was submitted by the bank that all that was necessary for it to prove was that the bank advanced money to the debtor to purchase inventory and that the money advanced was so utilized. Thereafter, it was submitted, the purchase-money security interest continued indefinitely. More specifically, it was argued that the security interest in proceeds from the sale of inventory extended to replacement inventory when proceeds from the sale of inventory were generated, and thereafter utilized to buy new inventory.

Section 30(1) of the P.P.S.A. states that a buyer of goods sold in the ordinary course of business of the seller takes free of any perfected or unperfected security interest unless the secured party can prove the buyer knew that the sale constitutes a breach of a security agreement. The debtor was not in breach of its security agreement with the bank when it sold its inventory. Paragraph 7 expressly states that the debtor was "entitled to sell the same in the ordinary course of business". Thus, the security interest of the bank in the inventory, whether a purchase-money security interest or otherwise, disappeared when the debtor sold its inventory to customers.

Section 28(1) of the P.P.S.A. provides that where collateral gives rise to proceeds, the security interest in the collateral extends to the proceeds. The general security agreement granted to the bank contained a similar provision. However, there is no provision in the P.P.S.A. nor in the general security agreement, whereby an unrealized security interest in proceeds automatically extends to personal property acquired by the proceeds.

Paragraph 7 of the general security agreement, which permitted sale of the collateral in the ordinary course of business, also stated:

> All proceeds of sale shall be received as trustee for the Bank and shall be forthwith paid over to the Bank.

It seems rather apparent the bank did not insist on compliance with the foregoing requirement. Quite simply, the bank relinquished its security interest in the proceeds from the sale of inventory.

The proceeds were no doubt utilized to carry on the business of the debtor, including the purchase of replacement inventory. The bank possessed a security interest in the replacement inventory because the general security agreement covered after acquired property. But that does not mean that the bank "gave value for the purpose of enabling the debtor to acquire rights" in the replacement inventory, thereby creating a purchase-money security interest. There was no evidence that the proceeds were paid to the bank and thereafter advanced to the debtor to purchase new inventory.

IV

The evidence adduced to establish the purchase-money security interest claimed by the bank consisted of the affidavit of an assistant manager of the bank and the affidavit of an officer of the debtor. In the first affidavit it was merely deposed that the bank "gave value" for the purpose of enabling the debtor to acquire rights in the goods, wares and merchandise and all other items of inventory thereafter purchased by the debtor.

In the affidavit of the officer of the debtor it was deposed that the purpose in granting the general security agreement to the bank was to borrow money to acquire inventory; that the bank advanced funds from time to time which were used for the acquisition of inventory; that the inventory distrained by Marathon resulted from money advanced by the bank; and that the said officer had not injected any of her own money into the business. More significantly, it was also deposed that the inventory, as it now exists, was obtained through direct financing from the bank and "through proceeds obtained from that inventory's sales" subsequent to the execution of the general security agreement.

There was no evidence whatever revealing the amount of money advanced by the bank to the debtor in 1983 as the "value" for the granting to another general security agreement. There was also no evidence of any specific advance to the debtor since that time. No ledger cards, bank statements, cancelled cheques or invoices for inventory were produced.

The total amount owed to the bank presumably includes interest. The debt was not segregated as to principal and interest. The interest portion could not possibly represent "money advanced". Except for the foregoing general statements in the two affidavits, there was no evidence that the distrained inventory was purchased with money "advanced" to the debtor by the bank, as opposed to money generated by the debtor's business.

The bank has failed to establish that the $53,170.74 owed by the debtor represents money advanced to the debtor for the purpose of enabling the debtor to acquire the inventory which was distrained. More importantly, the bank has not established that the sum of $53,170.74 was applied toward the acquisition of this particular inventory.

10 The appellant attacks this conclusion and raises three main issues which we paraphrase as follows:

11 1. Did the learned chambers judge err in law in holding that there is no provision in the Personal Property Security

Act whereby an unrealized security interest in proceeds automatically extends to personal property acquired by the proceeds?

12 2. Did the appellant bank lose its security interest in the proceeds from the inventory by permitting the proceeds to be retained by Kiddies for the purpose of carrying on its business, including the purchase of replacement inventory, rather than requiring Kiddies to pay the proceeds to the bank, as required by para. 7 of the security agreement, and then advance funds for the purchase of new inventory?

13 3. Did the appellant bank meet the evidentiary burden of establishing that it "gave value for the purpose of enabling the debtor [Kiddies] to acquire rights in the replacement inventory", thereby creating a purchase money security interest within the intendment of s. 25(1)(*a*) and (2) of the Landlord and Tenant Act?

14 We first turn to the appellant's attack on the conclusion that "there is no provision in the Personal Property Security Act nor in the general security agreement, whereby an unrealized security interest in proceeds automatically extends to personal property acquired by the proceeds". As a starting point, we observe that the broad language of para. 3.08 of the security agreement includes property acquired by the proceeds. The threshold question raised by the appellant must be answered in the affirmative. Section 2(*ee*) of the Personal Property Security Act deals specifically with the issue in these terms:

(*ee*) "proceeds" means *identifiable or traceable personal property in any form or fixtures derived directly or indirectly from any dealing with the collateral or proceeds therefrom*, and includes insurance payments or any other payments as indemnity or compensation for loss or damage to the collateral or proceeds therefrom, or any right to such payment, and any payment made in total or partial discharge of an intangible, chattel paper, instrument or security; and money, cheques and deposit accounts in banks, credit unions, trust companies or similar institutions are cash proceeds and all other proceeds are non-cash proceeds. [emphasis added]

15 On this point, we also refer to the following passages from the annotation at 6 P.P.S.A.C. 67 where the learned author says:

In *C.I.B.C. v. Marathon Realty Co.*, the bank argued that its purchase-money security interest in the debtor's inventory extended to include both the proceeds from the sale of the original inventory and the replacement inventory purchased with those proceeds. In its reasoning, the Court noted that s. 28(1) of the P.P.S.A. provides that where collateral gives rise to proceeds, the security interest in the collateral extends to those proceeds. Therefore, the bank's security interest included the proceeds generated from the sale of the original inventory.

However, the Court stated that there is no provision in the P.P.S.A. whereby an unrealized security interest in proceeds automatically extends to personal property acquired by the proceeds, and therefore decided that the bank's security interest in the proceeds did not extend to the replacement inventory. In reaching this conclusion, the Court failed to note that the statutory definition of proceeds found in s. 2(*ee*) of the P.P.S.A. includes personal property in any form derived directly or indirectly from any dealing with the collateral or proceeds therefrom. It is respectfully submitted that, based on a reading of ss. 2(*ee*) and 28(1) of the Act, a secured party's security interest extends to include proceeds of proceeds. Therefore, the bank's security interest in the original inventory extended to proceeds from its sale, and also included the replacement inventory as proceeds of proceeds.

16 The respondent does not dispute this point but contends that such error is not material to the basic issue because priority between the appellant bank and the respondent landlord must be determined by s. 25 of the Landlord and Tenant Act: see *Dube v. Bank of Montreal* (1986), 5 P.P.S.A.C. 269, 27 D.L.R. (4th) 718, 45 Sask. R. 291 (C.A.). With that starting point, the respondent, while accepting that "proceeds" is defined in broad and all encompassing language in s. 2ee) of the Personal Property Security Act, contends that there is no such provision in the Landlord and Tenant Act for a claim to "proceeds" -- only purchase-money security interests within the intendment of the Landlord and Tenant Act are granted priority. The respondent asserts that a purchase-money security interest under the Landlord and Tenant Act[FN1] is not as encompassing as under the Personal Property Security Act. The respondent further asserts that to obtain priority over a landlord, such a secured creditor must obtain payment from the tenant for inventory in which he has a purchase-money security interest. When inventory is sold the purchase- money security interest (within the intendment of the Landlord and Tenant Act) disappears. While the secured creditor might have priority between claimants under the Personal Property Security Act as a "proceeds" claim under s. 34(2) [FN2], such a claim does not qualify as a purchase-money security interest under s. 25 of the Landlord and Tenant Act and therefore does not take priority over the

landlord's rent claim. This is the same definition as set forth in s. 2(*gg*)(i) and (ii) of the Personal Property Security Act which reads:

(*gg*) "purchase-money security interest" means:

(i) a security interest that is taken or reserved by a seller, lessor or consignor of personal property to secure payment of all or part of its sale or lease price;

(ii) a security interest that is taken by a person who gives value for the purpose of enabling the debtor to acquire rights in or to the personal property, to the extent that the value is applied to acquire such rights.

17 We reject the respondent's contention that a purchase-money security interest should be construed, for the purposes of s. 25 of the Landlord and Tenant Act, in the restrictive fashion contended for. We recognize this section was designed to resolve the inevitable priority conflicts between the landlord's lien arising by operation of law and a competing security interest in the same property -- inventory in this case. With the enactment of s. 25, the legislature essentially brought the concept of purchase-money security interest within the purview of the Landlord and Tenant Act for the purposes of priority determination. This was a clear attempt to clarify and resolve the priorities between landlords and secured parties. Under this legislation, a landlord retains his traditional priority in most instances. However, under s. 25 his claim is now subordinated in certain defined circumstances to a purchase-money security interest. We do not think that the non-inclusion of "proceeds" in the Landlord and Tenant Act mandates a different approach to the concept of purchase-money security interest under the Landlord and Tenant Act, which is different from such an interest under the Personal Property Security Act. In our opinion, such approach is not compatible with the legislative objective of simplifying the law governing commercial trans actions. In our opinion legislative Acts should be construed in such a manner as to reconcile provisions and render them consistent and harmonious. After reading the relevant provisions of the Personal Property Security Act and the Landlord and Tenant Act, we conclude that the legislature never intended to create a purchase-money security interest under the Landlord and Tenant Act, which is different from such an interest under the Personal Property Security Act. Accordingly, we find no conflict in the two Acts. Furthermore, this approach comports with the approach taken by Matheson J., in *Prince Albert Credit Union v. Cudworth Farm Equip. Ltd.* (1985), 61 C.B.R. (N.S.) 49, 5 P.P.S.A.C. 116, 45 Sask. R. 67 (Q.B.), where the court was called upon to deal with the purchase-money security interest under s. 56(1) of the Labour Standards Act. [FN3] We refer in particular to the following passages from the reasons for judgment at p. 119:

The phrase "purchase-money security interest" is defined in s. 56(1) of the Labour Standards Act, and includes a security interest that is taken or reserved by a seller of personal property to secure payment of all or part of its sale price. The purpose of the security agreement executed by Cudworth in favourof Case was to create a security interest in the dealer's inventory of Case equipment which was being financed by Case. A financing statement was registered within the times prescribed in s. 21 of the P.P.S.A., and the security interest, therefore, became perfected upon Cudworth acquiring rights in the equipment.

The principal argument of the Department of Labour was not that Case did not possess a purchase-money security interest, nor that the interest did not extend to "proceeds", but that the money in Cudworth's bank account did not fall within the definition of "proceeds" in s. 2(*ee*) of the P.P.S.A., which states that "proceeds" means "identifiable or traceable personal property in any form ...".

18 We now turn to the second issue -- the appellant's attack on the chambers judge's conclusion that the bank lost its security interest in the inventory proceeds by not insisting that the debtor (Kiddies) pay over all proceeds of sale forthwith to the bank as required by para. 7 of the security agreement.

19 As a starting point with respect to this issue, we observe that the appellant bank complied with all the statutory requirements for the creation of a security interest. However, implicit in the reasons for judgment is the requirement that a lender must strictly enforce each contractual term in the security agreement -- in this case require that the debtor forthwith pay over all proceeds of the sale of inventory to the bank and then take out a new loan or advance to purchase new inventory. If this is not done, then the lender relinquishes its security interest in the proceeds.

20 Again, we refer to the annotation at 6 P.P.S.A.C. 67, where the learned author, referring to the decision under

appeal, observes:

The Court also decided that in not insisting that the debtor pay over all proceeds of sale forthwith to the bank in compliance with paragraph VII of the General Security Agreement, the bank relinquished its security interest in those proceeds. It is respectfully suggested that paragraph VII was probably inserted by the secured party into the General Security Agreement as a preventative measure to ensure that title to the proceeds remained with the bank. The P.P.S.A. does not stipulate that the secured party loses its security interest if it elects to not strictly comply with each contractual term inserted in the security agreement, while otherwise meeting all statutory requirements for the creation of a security interest. The Court's decision that the bank's acquiescence to the debtor's noncompliance with the clause terminated its security interest runs counter to the spirit of the Act, which is to give parties to a commercial transaction flexibility in creating their own security devices and facilitating commercial transactions.

21 We agree with this approach. A lender should not be required to daily police the activities of its borrower so that para. 7 of the agreement or any similar provision is rigidly enforced to avoid the loss of a security interest in the proceeds of the sale of inventory. While such a policing operation would simplify the problem of tracing "proceeds", such cumbersome formalities seem hardly compatible with the underlying purpose of the Personal Property Security Act -- to simplify the law governing commercial transactions and also to bring it up to date with commercial practices. Furthermore, the Personal Property Security Act does not require a lender to engage in such policing exercises. As inventory is sold, proceeds arise in the retailer's hands. A financier can demand that such proceeds be paid over in specie, and then if necessary, that a new loan be negotiated as new inventory is required. However, such a business practice will not affect other creditors. They will be in the same position whether the creditor arrangement is revolving or stationary. In one case the financier requires the paying over in specie and then negotiation of a new loan -- often time-consuming and unnecessary acts -- and in the other the financier does not impose or enforce such stringent requirements. However, both patterns of financing reach the same end. In neither case is the security interest effective for more than the outstanding balance of the loan, even though the value of the collateral may be greatly in excess of the balance. In both cases, whatever is left after the secured claim is paid is available for other creditors.

22 Under the Personal Property Security Act a security interest continues in "proceeds" as inventory is sold. Generally speaking, an interest continues in whatever is received upon disposition of the proceeds; in this way a continuous, perfected security interest is provided -- inventory, proceeds, inventory again, more proceeds, and so on. In short, to hold that a debtor and secured party legally need not engage in a continuing turnover, pay-over arrangement to have a perfected non-attackable transaction comports with commercial reality. Why require needless acts of no benefit to other creditors when the financier and borrower can accomplish by a simple means what they could unquestionably do by a more elaborate and time consuming arrangement. With a filed financing statement, no one is misled by this type of financing. This aspect of commercial practice is canvassed by our brother Cameron in *Chrysler Credit Can. Ltd. v. Royal Bank*, [1986] 6 W.W.R. 338, 6 P.P.S.A.C. 153, 30 D.L.R. (4th) 616, 50 Sask. R. 216 (C.A.), particularly at pp. 347 and 348 W.W.R.

23 The appellant is entitled to succeed on this ground.

24 We next turn to the appellant's attack on the chambers judge's conclusion that it had "failed to establish that the $53,170.74 owed by the debtor represents money advanced to the debtor [Kiddies] for the purpose of enabling the debtor to acquire the inventory which was distrained". The respondent contends that this case stands on all "fours" with *Dube v. Bank of Montreal*, supra, where the court stated, inter alia, at p. 295:

The chattel mortgage does not state that the money was advanced for the purpose of enabling the debtor to acquire the chattels and it does not indicate that any portion of the $60,000.00 has been applied toward the acquisition of rights in property. The appellant sought to buttress that shortfall by filing an affidavit of one of its employees stating that the $60,000.00 was loaned for the purpose of enabling Cadentia to purchase certain chattels listed in the schedule attached to the chattel mortgage. The respondent submits that that evidence of intention should not be admitted as it is inadmissible under the parole [sic] evidence rule. I do not have to decide that issue. There is evidence that the Bank advanced money to Cadentia as part of the purchase price of the business it acquired. There is no evidence that the money advanced by the Bank was advanced for the purpose of enabling the appellant Bank to acquire rights in personal property, or any evidence that the $60,000.00 was applied to acquire such property rights.

The appellant Bank has failed to satisfy the onus of establishing that it has a purchase-money security interest and therefore the landlord has a prior claim to the chattels under its right of distress.

25 Our attention has been called to the following passages from the annotation on *Dube v. Bank of Montreal* (1985-86), 5 P.P.S.A.C. 275.1 to 275.3, where the learned author states:

Prior to the rendering of the *Dube v. Bank of Montreal* decision, it was generally thought that a secured party claiming a purchase-money security interest in certain collateral would be permitted by the Court to introduce affidavit evidence to establish that its security interest came within the statutory definition of a purchase-money security interest. The Saskatchewan Court of Appeal has now ruled that such affidavit evidence is inadmissible under the parole [sic] evidence rule. The Court indicated that the necessary ingredients to create a purchase-money security interest as defined in s. 2(*gg*) of the P.P.S.A. (Sask.) must be found in the security agreements themselves. The security agreement must establish that a security interest was created by the advancing of money for the purpose of enabling the debtor to acquire rights to the property, and that the money so advanced was applied towards the acquisition of those rights.

In *Dube v. Bank of Montreal*, the debtor had executed two security agreements in favour of the Bank: a chattel mortgage and a sales agreement. The Court looked to the terms of the agreements for evidence of the creation of a purchase-money security interest. The Court noted that the chattel mortgage did not include a term stipulating that the money was advanced for the purpose of enabling the debtor to acquire the chattels, nor was there a clause indicating what portion of the money advanced was to be applied towards the debtor's acquisition of rights in the chattels. There were no provisions in the sales agreement allocating the purchase price between the personal property and other assets being acquired by the debtor. The Court concluded that the Bank did not hold a purchase-money security interest in the collateral based on its reading of the two documents. Therefore, priority went to the distraining landlord.

The result of this decision is that a secured party will not be deemed to be the holder of a purchase-money security interest, even if *in fact* its security interest comes within the statutory definition, unless evidence of the purchase-money security interest can be found within the terms of the security agreement. Practitioners in Saskatchewan will no doubt find this result surprising, given that the P.P.S.A. (Sask.) has no such requirements regarding the creation of a purchase-money security interest.

The definition of a purchase-money security interest in Saskatchewan reads as follows:

s. 2(*gg*) ...

(i) a security interest that is taken or reserved by a seller, lessor or consignor of personal property to secure payment of all or part of its sale or lease price;

(ii) a security interest that is taken by a person who gives value for the purpose of enabling the debtor to acquire rights in or to the personal property, to the extent that the value is applied to acquire such rights;

(iii) the interest of a lessor of goods under a lease for a term of more than one year; or

(iv) the interest of a person who delivers goods to another person under a consignment;

The requirement in s. 2(*gg*)(ii) is similar to that found in the identically- worded Ontario and Manitoba sections (see P.P.S.A. (Ont.) R.S.O. 1980, c. 375, s. 1(*s*)(ii) and P.P.S.A. (Man.) S.M. 1973, c. 5, s. 1(*u*)(ii)). All three of these provinces require that the money must be loaned to enable the debtor to acquire rights in the collateral, and in fact *be applied* to acquire such rights.

The three provincial Acts require this factual test to be conducted in order to establish the creation of a purchase-money security interest. The typical purchase-money transaction will be drawn up in a document executed by the debtor. Following the execution, the loan will be advanced. In order to satisfy the factual test of the definition, evidence concerning the loaning of the money and its application to acquire collateral must be led. Whether it be *viva*

voce or by affidavit, such evidence is required by the Act to establish compliance with the definition.

The parole evidence rule relates to the admission of evidence to clarify an ambiguous contract. See *Hawrish v. Bank of Montreal*, [1969] S.C.R. 515, 66 W.W.R. 673, 2 D.L.R. (3d) 600 (S.C.C.) and Fridman, G.H.L., The Law of Contract in Canada (Carswell, Toronto, 1986) at 433 *et subq.* The Act requires the admission of evidence not for any clarification or alteration of the contract, but to satisfy the conditions of the definition. Due to the nature of the transaction, it can only be conclusively ascertained that the monies loaned were applied to acquire the collateral after the transaction has been completed. A statement to that effect in the security document is self-serving and not evidence the loans were so applied. Therefore, the Act contemplates the introduction of the very evidence banned by the Court of Appeal. The issue would not appear to be one of parole evidence with respect to written documents, but parole evidence to establish that the requirements of the statutory definition have been satisfied.

The effect of this decision is that any secured party claiming a purchase-money security interest must now ensure that its security agreement is couched in terms paralleling the statutory definition, and contains sufficient additional facts to establish the creation of such an interest. It is hoped that the decision will be distinguished on the grounds suggested and not applied as persuasive authority in other jurisdictions.

26 With respect, we do not construe the reasons in *Dube v. Bank of Montreal* as supporting the above conclusions. However, we observe that the original reasons as found in (1986), 5 P.P.S.A.C. 269, were recalled and varied, with para. 9 (as quoted above from the Saskatchewan Reports) having been altered to leave the issue of admissibility of such evidence open for future consideration.

27 After hearing full argument in this appeal, we are all of the opinion that the affidavit evidence of Craig Barclay and Terry Taczlikowicz is properly admissible on the issues raised in this case.

28 The initial question that arises is whether there is uncontradicted evidence that the money advanced by the bank was advanced for the purpose of enabling the debtor, Kiddies, to acquire rights in the property under seizure. There is a further subsidiary question -- whether there is evidence that the moneys so advanced were applied to acquire such rights. In our opinion, the answer to these questions, based upon the uncontradicted evidence, must be in the affirmative. We again refer, in particular, to the affidavit of Terry Taczlikowicz, owner and manager of Kiddies, where she deposes as follows in paras. 4, 5, 6 and 7 of her affidavit:

4. THAT the purpose for executing Exhibit "A" was to be able to borrow money which was used to acquire inventory.

5. THAT subsequent to the execution of Exhibit "A", the Canadian Imperial Bank of Commerce advanced funds to me from time to time, which were used for the acquisition of inventory, for purposes of retail sale in my business.

6. THAT all inventory currently possessed by Kiddies Korner Clothiers Ltd., which is distrained by Marathon Realty Company Limited results from the monies which have been advanced to me by the Canadian Imperial Bank of Commerce, subsequent to the execution of Exhibit "A".

7. THAT I have not injected into the business any personal or outside funds whatsoever, by way of loan, or otherwise, and the inventory as it now exists have been obtained through direct financing from the Canadian Imperial Bank of Commerce subsequent to the execution of Exhibit "A", and through proceeds obtained from that inventory's sales subsequent to the execution of Exhibit "A".

29 We observe that the respondent did not seek to challenge this affidavit evidence. No application was made to cross-examine the deponent and no material was filed in reply. The respondent did not seek trial of an issue with discovery and production of documents. We have earlier observed that the entire evidence in this case is documentary or in the form of unchallenged affidavit evidence. Under such circumstances we are able to pass upon the weight and sufficiency of the evidence and substitute our judgment for the chamber judge's conclusion.

30 Since the uncontradicted evidence supports the appellant's contention, we give effect to this ground of appeal and hold that the appellant has satisfied the evidentiary burden on it under s. 25 of the Landlord and Tenant Act.

31 We accordingly allow the within appeal and declare that the appellant's security interest in the inventory is prior to the respondent landlord's claim under its distress.

32 At the hearing of this appeal, it was common ground that the respondent landlord had disposed of the inventory in question and received approximately $18,000. However, the appellant did not participate in any such arrangement and expressed its reservations about the matter of disposition and the adequacy of the proceeds realized upon the sale of the distrained inventory. Failing agreement between the parties on this issue, we remit the matter to Queen's Bench for hearing and determination as to whether the distrained inventory was disposed of in a commercially reasonable and appropriate manner and for any assessment of damages owing by the respondent to the appellant arising from such seizure and sale.

33 We award costs to the appellant in this court and on the application to Queen's Bench with the same to be taxed at double col. V.

34 Before we part from this appeal, we observe that the appellant invited this division of the court to re-examine the threshold conclusion in *Dube v. Bank of Montreal* -- that the right of distress is a "lien, charge or interest given by statute" to which the Personal Property Security Act does not apply. The record inQueen's Bench indicates that the appellant also sought to raise the point before the chambers judge. In view of our conclusion, we do not find it necessary to address this issue. Accordingly, the point is left open for future examination.

Appeal allowed.

FN1. Section 25(1)(*a*)(i) and (ii) of the Landlord and Tenant Act reads: "25(1) In this section

(*a*) 'purchase-money security interest' means:

(i) a security interest that is taken or reserved by a seller, lessor or consignor of personal property to secure payment of all or part of the sale or lease price; or

(ii) *a security interest that is taken by a person who gives value for the purpose of enabling the debtor to acquire rights in or to personal property, to the extent that the value is applied to acquire such rights.*

[emphasis added]

FN2. Section 34(2) of the Personal Property Security Act reads:

(2) Subject to section 28 and subsection (4) of this section, a purchase-money security interest in inventory or its proceeds has priority over any other security interest in the same collateral given by the same debtor if:

(*a*) the purchase-money security interest in the inventory is perfected at the time the debtor receives possession of it; and

(*b*) the purchase-money secured party serves a notice on any person who has registered a financing statement or

security agreement covering the same type or kind of collateral, unless the purchase-money secured party registers his interest before that time, in which case the notice shall be served on secured parties who have registered financing statements or security agreements covering the same type or kind of collateral of the debtor before registration by the purchase-money secured party.

FN3. This definition, which is similar to s. 25 of the Landlord and Tenant Act, reads:

56. -- (1) In this section:

(*a*) 'purchase-money security interest' means:

(i) a security interest that is taken or reserved by a seller of a personal property to secure payment of all or part of its sale price; or

(ii) a security interest that is taken by a person who gives value for the purpose of enabling the debtor to acquire rights in or to the personal property, to the extent that the value is applied to acquire such rights;

(*b*) 'security interest' means an interest in property that secures payment or performance of an obligation.

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[Indexed as: **Central Guarantee Trust Co. v. Red Coach Rentals Corp.**]

CENTRAL GUARANTEE TRUST COMPANY
and ADELAIDE CAPITAL CORPORATION
v. RED COACH RENTALS CORPORATION and
MIDWESTERN AUTO RENTALS & LEASING
CORPORATION and ROYNAT INC.

Ontario Court of Justice (General Division [Commercial List])
Feldman J.

Heard – February 13, 14, 15 and 16, 1995.
Judgment – March 23, 1995.

Perfection of security interest – Registration – Errors in completing financing statements – Misclassification or misdescription of collateral – General – Secured partner misclassifying collateral by marking "other" and "motor vehicle" box rather than "inventory" box in financing statement – Misclassification not curable – Personal Property Security Act, R.S.O. 1990, c. P.10, ss. 46(3), 46(4).

Perfection of security interest – Registration – Errors in completing financing statements – Application of curative provisions – Secured party misclassifying collateral in financing statement by marking "other" and "motor vehicle" box rather than "inventory" box – Financing statement consequently not clearly designating what collateral was perfected – Reasonable person likely to be misled – Personal Property Security Act, R.S.O. 1990, c. P.10, s. 46(4).

Transitional provisions – Application of prior Act to priority dispute – Even if security interest effective under prior Act, revised Act provisions should be used to determine if security interest continuously perfected – Personal Property Security Act, R.S.O. 1990, c. P.10, s. 76(4).

The plaintiff trust company, CGT, along with its assignee, A, and a finance company, R, each had a secured interest in the same rental fleet of motor vehicles owned by a transportation company which was in receivership, and each claimed priority.

The plaintiff trust company, CGT, financed the acquisition in 1986 of a rental fleet of motor vehicles for the defendant debtor transportation company, RC. The collateral secured included "merchandise", which was defined to encompass all motor vehicles in the fleet and any proceeds arising from the sale of these motor vehicles. The financing statement was registered outside the 30-day requirement under the prior *Personal Property Security Act* (Ont.). In addition, although the financing statement was accurately completed by the trust company, a registry official made an error and incorrectly recorded a "no" for a "yes" in the "motor vehicles" box. Both parties agreed that the Ministry was entirely responsible for this mistake; for the purposes of this case, the registration has been treated as if a search would have revealed exactly what was on the financing statement.

As each vehicle was acquired by the debtor, a chattel mortgage was executed and a fresh financing statement, including the VIN, was properly registered. In 1989, the trust company entered into a new general security agreement and financing and security agreement with the debtor in addition to the 1986 security agreement. A financing statement for the financing and security agreement was also registered outside the 30-day period, but was correctly completed and recorded into the register. A financing statement for the 1989 general security agreement was registered in a timely fashion, but incorrectly marked the "inventory" box without marking the "motor vehicles" box. This error was corrected by a financing change statement at about the same time that the transportation company went into receivership in 1991. The GSA financing statement did list under the general description area "General Security Agreement on file" which included "all motor vehicles and chassis now or hereafter owned or acquired by the corporation", plus all proceeds from these vehicles. After 1989, the trust company continued to enter and register chattel mortgages in respect of vehicle financing on the debtor's behalf as they were acquired. It then assigned its interest to A.

A finance company, R, had entered into a security agreement with the transportation company's parent company. It obtained a floating charge debenture on all assets, subject only to a limited interest of a bank, which also included a guarantee by the transportation company. A financing statement for this agreement was registered under the prior Act in a timely fashion; however, the collateral was described as "other" and "motor vehicle" rather than "inventory". R's solicitor performed a registry search in mid-1989 before the trust company's 1989 registrations, and therefore was not aware of them. The trust company was not aware of R's interest in the rental fleet from its searches; it knew from speaking to R that R was financing building construction, but not that R had or claimed any security interest in the motor vehicles.

The receiver had paid the proceeds from the sale of vehicles to the trust company prior to R's claim of priority. The receiver has held any proceeds of sale subsequent to R's claim.

The trust company argued that its security interest should have priority because it had been continuously perfected and pre-dated R's security interest.

R argued that, although it had not marked the "inventory" box in its financing statement, this error should be cured by s. 46(4) of the Act since it was clear from the offer to finance and the debenture that the motor vehicles were part of its security interest and, therefore, a reasonable person would not be materially misled by the error in the financing statement. R also argued that the proper box need not be marked as long as the collateral was sufficiently identified elsewhere in the statement so that a reasonable person would not be materially misled. R also argued that it was entitled to the surplus proceeds being held by the receiver because the trust company's claim was limited to the amount outstanding for each vehicle. Relying on s. 46(3), R argued that since a description of each vehicle was contained within each financing statement, the assignee was restricted to recovering only the proceeds of each individual vehicle.

Held – The trust company's security interest had priority over R's interest; R was not entitled to the surplus proceeds.

Determination of the issues relating to the trust company's security agreements and financing statements arising in 1986 and 1989 was not crucial for this case. Under s. 76(4) of the new P.P.S.A., priority between security interests under agreements made while the old P.P.S.A. was in force should be determined in accordance with the law as it existed before the new P.P.S.A. was in effect, if the security interests had been continuously perfected since that day. Thus, the key issue was whether R had a perfected security interest in the motor vehicles from the date of its registration.

The purpose of the curative provision was not to perfect security which was not perfected before, but to maintain the validity of an otherwise defective financing statement by ignoring an error or omission. To find in R's favour, the court must be convinced that R's financing statement was sufficient in spite of its error to perfect the security in the desired collateral and that R's error was not likely to mislead a reasonable person. However, a creditor may have reasons for registering against only certain collateral even where it has security over more; a reasonable person would, or at least could, believe on the basis of R's financing statement that R had deliberately chose to limit its priority to certain collateral, in spite of the all-encompassing security agreement. The register must speak for itself; the system must have certainty and reliability built into it to avoid the need to go to court. A person searching the system should not be required to make any inquiry of a registrant for clarification. If the wrong classification box was indicated, other information in the financing statement must clearly and unequivocally designate the intended collateral. In this case, R's financing statement was at best ambiguous; thus, R did not have a perfected interest in the motor vehicle inventory at any time.

As for R's claim to the surplus proceeds, the effect of s. 46(3) was to limit the class of collateral perfected by a financing statement, not the debt for which the collateral stands as security. The perfected security interests in the motor vehicles assigned to A maintained their priority with respect to their proceeds of sale as covered under the chattel mortgages.

Cases considered

Adelaide Capital Corp. v. Integrated Transportation Finance Inc. (1994), 6 P.P.S.A.C. (2d) 267, 16 O.R. (3d) 414, 23 C.B.R. (3d) 289, 111 D.L.R. (4th) 493 (Gen. Div. [Commercial List]) – referred to.

C.T.L. Uniforms Ltd. v. ACIM Industries Ltd. (1981), 1 P.P.S.A.C. 308, 33 O.R. (2d) 139, 123 D.L.R. (3d) 702 (S.C.), affirmed (1982), 35 O.R. (2d) 172, 132 D.L.R. (3d) 192 (C.A.) – referred to.

Croeker (Trustee of) v. Kubota Tractor Canada Ltd. (1985), 5 P.P.S.A.C. 85 (Ont. S.C.) – referred to.

Hongkong Bank of Canada v. National Bank of Canada (1990), 1 P.P.S.A.C. (2d) 73, 73 O.R. (2d) 28, 72 D.L.R. (4th) 372 (H.C.) – referred to.

Lambert, Re (1994), 7 P.P.S.A.C. (2d) 240, 20 O.R. (3d) 108, 28 C.B.R. (3d) 1 (C.A.) – followed.

Touche Ross Ltd. v. Ford Credit Canada Ltd. (1985), 5 P.P.S.A.C. 128 (Ont. S.C.), affirmed (1987), 7 P.P.S.A.C. xxxii (note), (sub nom. *Re 533812*

Ontario Ltd.), 64 C.B.R. 80 (note) (Ont. C.A.) – referred to.

Statutes considered
Personal Property Security Act, R.S.O. 1980, c. 375.
Personal Property Security Act, R.S.O. 1990, c. P.10 –
s. 46(2)
s. 46(3)
s. 46(4)
s. 49
s. 53
s. 76
s. 76(4)

Regulations considered
Personal Property Security Act, R.S.O. 1990, c. P.10 –
R.R.O. 1990, Reg. 912,
s. 3
s. 3(1)(f)

Canadian Abridgment (2nd) Classification
Personal Property Security
III.1.e.iii.A.
Personal Property Security
III.1.e.v.
Personal Property Security
VIII.

APPLICATION to determine priorities between two secured parties with interests in the same collateral.

Mary Margaret Fox and *Craig J. Hill*, for Adelaide Capital Corp., plaintiff (defendant by counterclaim).

W.G. Shanks, for Roynat Inc., defendant (plaintiff by counterclaim).

(Doc. B1/92)

1 March 23, 1995. FELDMAN J.: – The parties ask the court to determine a priorities dispute between Adelaide and Roynat on the rental fleet of motor vehicles of Red Coach which is now in receivership. Both parties have registered security but each registration has some problem which could invalidate it.

2 The court was advised during the trial that there are also two other actions outstanding relating to the same security. One is by Roynat against its solicitor who registered its security, and the other is by Roynat against the PPS Assurance Fund. Counsel for the solicitor and for the fund apparently attended the pretrials of this action, and confirmed in writing to the court

during the trial that the parties for whom they act in those proceedings agree to be bound by the determination of this court on the priority issue.

Facts

3 Guaranty Trust Company of Canada, and after amalgamation in 1988, Central Guaranty Trust Company, based in Winnipeg, financed the acquisition of the rental fleet of Red Coach Rental Corporation, a car rental and leasing operation in Western Ontario. The financing involved a revolving line of approximately $10,000,000. The parties had a financing and security agreement dated June 3, 1986 which granted to Guaranty Trust a continuing security interest in the collateral, which was merchandise and proceeds. Merchandise was defined as:

> "Merchandise" shall mean all new rental and lease vehicles, attachments, accessories and replacements now held or hereafter acquired in the dealer's fleet set forth in schedule "A" hereto.

Schedule "A" provides:

> All motor vehicles in which the debtor has interest whether they be rental vehicles, lease vehicles or used vehicles and attachments, accessories and replacements, the acquisition of which was financed by the secured party, plus, proceeds pertaining to the lease or disposal of these vehicles.

The financing statement in respect of the 1986 security agreement was registered a few days beyond the 30-day requirement under the old P.P.S.A. Furthermore, although the financing statement was accurately completed by Guaranty Trust, the Ministry official made an error when entering the information into the system and under the "motor vehicles" box, entered "no" rather than "yes", as shown on the financing statement. It is common ground between the parties before this court that the Ministry is responsible for any consequences which may flow from this error, and for the purposes of the case before this court, the contents of the registration have been treated as if a search would have revealed exactly what was on the financing statement.

4 Guaranty Trust and subsequently Central Guaranty took chattel mortgages for the vehicles as they were acquired by Red Coach, either individually or in groups and registered financing statements in respect of those chattel mortgages. The evidence

was that these chattel mortgages and registrations were for extra security and as they included the VIN numbers for each vehicle, they could be used for spot audit purposes to monitor the vehicles on their eventual sale.

5 In 1989, a decision was made at Central Guaranty to take new security agreements from Red Coach, a general security agreement ("GSA") and a new financing and security agreement and to register financing statements in respect to them, but that this new security would be in addition to and not in substitution for the 1986 security. The GSA had some clauses including the ability to appoint a receiver, which the financing and security agreement did not. Again the financing statement in respect of the financing and security agreement was registered beyond the 30-day period required by the old P.P.S.A. on September 5, 1989, but was accurately completed and entered on the register. In the "general collateral description" box are the words: "Financing agreement on title". In the financing agreement is the same definition of merchandise, and the same wording in Schedule A as in the 1986 financing and security agreement.

6 The financing statement in respect of the GSA was registered on time on September 1, 1989, but in respect of the collateral classification, inventory is included, but motor vehicles are shown as "no". This entry was corrected by a financing change statement registered around the time of the Red Coach receivership in 1991 after a search. In the general collateral description area on the financing statement are the words: "General Security Agreement on file". In the GSA the security includes a fixed charge on "all motor vehicles and chassis now or hereafter owned or acquired by the corporation", plus all proceeds of those vehicles, plus all machinery, equipment, goods and chattels now owned or subsequently acquired by the corporation.

7 In the meantime, Roynat was financing the construction of car rental facilities for North Woods Investment Corporation, the parent company to Red Coach, and in July 1989 entered into an offer of finance for $2,500,000 on the security of a charge on certain lands, some guarantees of the principals, plus the guarantees of two subsidiaries including Red Coach, supported by a collateral debenture including a floating charge on all assets subject to a prior floating charge of $500,000 in favour of CIBC "which will permit it to deal with these assets in the ordinary course of business or give security to its Bankers by way of an assignment of trade Account Receivables and Trade Inventories".

8 It is common ground between the parties that in law, the

clause just quoted can refer only to the financing of trade inventories by a bank and cannot refer to such financing by Central Guaranty, in spite of the evidence of Mr. Proke the assistant vice-president of Roynat in charge of this file at the time, and who signed the offer, who said that his understanding was that Central Guaranty was providing the inventory financing for Roynat, and that his intention and understanding were that Roynat's security on the Red Coach motor vehicle fleet would be behind that of Central Guaranty.

9 Red Coach gave Roynat a debenture to reflect the terms of the offer to finance dated September 6, 1989. A financing statement was registered in time under the old P.P.S.A. on September 15, 1989. However, under the collateral classification box, the only classification that is x'd is "other", not "inventory", and motor vehicles included in the collateral is x'd "yes". In the general collateral description are the words "floating charge debenture".

10 The solicitor for Roynat did a P.P.S.A. search on Red Coach in July 1989, but not afterward. Therefore, although he would have seen the 1986 registration by Guaranty Trust and at that time 173 chattel mortgage registrations for specific vehicles or groups of vehicles, he would not have seen the two 1989 registrations of the new GSA and financing and security agreement by Central Guaranty.

11 After 1989 Central Guaranty continued to place individual or group chattel mortgages in respect of the financing of individual vehicles for Red Coach. Although it did annual P.P.S.A. searches, the evidence was that because of the volume of the printout, it was reviewed by skimming. Central Guaranty was not aware from its searches that Roynat had any security on Red Coach. It did become aware from speaking to Roynat that it was financing building construction, but not that it had or claimed any security interest in motor vehicles of Red Coach.

12 The fund that is now being held by the receiver is proceeds from vehicles over which Central Guaranty had specific chattel mortgages registered after the Roynat debenture. Its interest in those chattel mortgages has been assigned to Adelaide. The receiver had already paid to Central Guaranty the proceeds of the sale of other vehicles before Roynat made its claim to priority. It was confirmed on the record that no claim is or will be made by Roynat for recovery of moneys already paid either against the receiver or against the liquidator of Central Guaranty and therefore neither of those parties required representation in this matter.

Issues

13 1. Is priority to be determined under the old or new P.P.S.A.?

14 2. The effect of the 1986 financing and security agreement and late filing of the financing statement to perfect the security interest in that agreement or to shelter the security granted in the subsequent 1989 agreements and all of the subsequent chattel mortgages, including in that context, the effect of the amalgamation of Guaranty Trust to become Central Guaranty in 1988.

15 3. Does the 1986 security agreement cover after-acquired property under the wording of Schedule A?

16 4. The effect of the 1989 financing and security agreement and late registration of the financing statement to perfect that security, plus the sheltering and coverage issues.

17 5. The effect of the 1989 GSA and timely registration of the financing statement which claims security in inventory but not including motor vehicles.

18 6. The effect of the Roynat security agreement and timely registration of a financing statement which claims security over motor vehicles but for the "other" classification of collateral and not for the "inventory" classification.

19 7. Whether the chattel mortgage financing statements limit their priority to the proceeds of each vehicle but do not give priority for cross-collateralization of vehicle proceeds as per the wording of the chattel mortgages themselves, because of the inclusion in the financing statements of a reference to each vehicle and its serial number.

Analysis

20 1. Section 76 of the new Act makes that Act applicable to all security agreements after 1976. However, by subs. (4), priority between security interests under agreements made while the old Act was in force:

> . . . shall be determined in accordance with the law as it existed immediately before the 10th day of October, 1989 if the security interests have been continuously perfected since that day.

In order to determine whether security interests have been continuously perfected since October 10, 1989, the provisions of the

new Act are applicable. If they were continuously perfected, then the priority between them is determined in accordance with the old Act. The effect in this case is that since all the general security of both parties predated the new Act, then if there was continuous perfection from October 1989, Roynat says its security is first because the Guaranty Trust 1986 registration was made out of time as was the 1989 and therefore of no effect, and the 1989 GSA registration did not include motor vehicles.

21 Therefore the key issue to be determined is No. 6, whether Roynat had, from the date of registration of its financing statement, a perfected security interest in the Red Coach motor vehicle fleet as collateral. This issue turns on the interpretation and application of s. 46(4) of the new P.P.S.A. which provides:

> (4) A financing statement or financing change statement is not invalidated nor is its effect impaired by reason only of an error or omission therein or in its execution or registration unless a reasonable person is likely to be misled materially by the error or omission.

Section 46(2) of the Act and s. 3 of R.R.O. 1990, Reg. 912 are also relevant. Section 46(2) provides:

> (2) Every financing statement and financing change statement to be registered under this Act shall be in the prescribed form.

Section 3 of the regulation sets out the contents of the financing statement:

> 3.(1) A financing statement shall set out in the appropriate place according to the information being entered,
>
> . . .
>
> (f) the classification of the collateral as consumer goods, inventory, equipment, accounts or that the classification is other than consumer goods, inventory, equipment or accounts or any combination thereof;
>
> (g) if a motor vehicle is included in the collateral, an indicator that it is included.

Roynat's position in argument was that the Red Coach rental vehicle fleet was inventory, and therefore in order to comply with s. 3(1)(f) of R.R.O. 1990, Reg. 912 under the P.P.S.A. it should have indicated the "inventory" classification, and that it therefore made an error or omission. Counsel for Adelaide took exception to this concession on the basis that its understanding of Roynat's position was that the vehicle fleet was not inventory

and therefore its registration was correct; flowing from that position, Roynat was not claiming that it had made an error. Now it concedes that an error was made.

22 Counsel for Adelaide further submitted in reply argument that there was no evidence led that Roynat made an error or believed it had made an error, or looking at it another way, that Roynat's completion of the financing statement was not deliberate in marking "other" as the collateral classification together with motor vehicles included. This failure to assert an error was consistent with the position which Adelaide understood Roynat was taking.

23 As I understood and confirmed with counsel, Roynat's position before the court is that the financing statement was sufficient to perfect Roynat's security interest in the Red Coach motor vehicle fleet, but that because the fleet was inventory, Roynat had not complied with s. 3(1)(f) of the regulation, which is in effect by definition an error or omission, but one which is cured by s. 46(4) because a reasonable person was not likely to be misled materially by the error or omission in the circumstances.

24 The issue of whether an error must necessarily be caused by inadvertence is an interesting one in the context of the applicability of this section to the designation and description of collateral.

25 The curative section does not perfect security which was not perfected before. Only a financing change statement can do that (s. 49). Of course a financing change statement does not operate retroactively but only gives priority from its registration (s. 53).

26 What the curative section does is maintain the validity of the financing statement and of its effect, whatever that is in each case, by ignoring the error or omission which would otherwise be noncompliance with the Act or the regulations resulting in invalidity.

27 The argument for curing an error is twofold:

(1) the financing statement was sufficient in spite of the error or omission to perfect the security in the desired collateral;

(2) because of that effect on the face of the financing statement, a reasonable person is not likely to be misled materially by the error or omission.

28 In this case Roynat is saying that it always intended to

claim priority by registration against the entire vehicle fleet or inventory of Red Coach. It says this is clear from the offer to finance and from the debenture, which is referenced in the general collateral description. Mr. Proke testified that the inventory of Red Coach was considered to be a significant part of Roynat's security when considering the loan, and that Roynat valued its interest in the excess equity in the vehicles to amount to over $2 million.

29 No evidence was led as to how the decision was made to refer to the collateral as "other" and to include motor vehicles, nor whether that decision was deliberate or inadvertent. What can be inferred however, is that the vehicles over which Roynat intended its claim to security were the inventory fleet and not some other vehicles not in inventory. Apparently Roynat took a position on discovery regarding definitions of inventory which would exclude these vehicles, i.e., a semantic or definitional argument. Whatever position it may have taken, what Roynat says is the identity of the vehicles never changed and was always clear, and no one could be misled materially by the failure to tick off the "inventory" box. By implication, the failure to do so was an error, whether advertent or inadvertent, because it caused a *prima facie* non-compliance with the regulations and therefore potential invalidity of the financing statement to secure the inventory.

30 The key to the correctness of Roynat's argument lies in the clarity of the form, and whether a person doing a search would know that Roynat was perfecting its security in the motor vehicle inventory fleet of Red Coach. If that is not clear, then it is not clear that there was an error or omission. If it is open to conclude from a search that Roynat deliberately chose to claim only a perfected priority in motor vehicles other than inventory, for example, executive vehicles, then how can the security be said to be perfected in inventory collateral, and how can it be said that no one was likely to be materially misled?

31 The Court of Appeal has recently had occasion to consider the effect and operation of s. 46(4) in *Re Lambert* (1994), 20 O.R. (3d) 108, 7 P.P.S.A.C. (2d) 240. In that case the error was in the name of the debtor and the issue was whether a reasonable person would be likely to be materially misled when that person could also search the register by the VIN number of the secured vehicle and thereby retrieve the financing statement that way. The case at bar does not involve inability to search because of the error, but the clarity of the claim for security.

32 In *Re Lambert*, the Court of Appeal has held that s. 46(4) is potentially applicable to any error in a financing statement.

Therefore it is potentially available to cure errors in the collateral classification. The court also confirmed the operation of the section: "Secondly, an error in a financing statement does not *per se* invalidate that statement or impair the security interest claimed by the statement. The validity of the financing statement is unaffected by the error unless the party seeking to invalidate the financing statement demonstrates that 'a reasonable person is likely to be misled materially by the error' " (p. 114 [O.R., pp. 247-48 P.P.S.A.C.).

33 [In] other words, the curative section does not give the court power to give new validity to a financing statement, but only prevents an error from invalidating what is already there, just because there has been some non-compliance, if the financing statement's intended effect is clear.

34 At p. 123 [O.R. p. 257 P.P.S.A.C.], the Court of Appeal described the effect of the curative section this way:

> The present curative proviso does not, however, fix on the part of the financing statement in which the error occurred, but instead looks to the effect of the error on the reasonable person. The present provision may cure any error no matter where it occurs in the financing statement . . ., but may not, in light of additional information, found in the same financing statement and available to the reasonable person, materially mislead that person.

By holding that any error can be cured, the effect is that a financing statement need not identify by an "x" the proper collateral classification in the financing statement, as long as the collateral is sufficiently identified elsewhere in the statement so that a person searching will not be materially misled.

35 This was the effect of the decisions relied on by Roynat under the curative provision of the old Act in the cases of *C.T.L. Uniforms Ltd. v. ACIM Industries Ltd.* (1981), 33 O.R. (2d) 139, 1 P.P.S.A.C. 308 (S.C.), affirmed (1981), 35 O.R. (2d) 172 (C.A.); *Hongkong Bank of Canada v. National Bank of Canada* (1990), 1 P.P.S.A.C. (2d) 73 (Ont. H.C.); *Croeker (Trustee in Bankruptcy) v. Kubota Tractor Canada Ltd.* (1985), 5 P.P.S.A.C. 85 (Ont. S.C.); *Re 533812 Ontario Ltd.; Touche Ross Ltd. (Trustee in Bankruptcy) v. Ford Credit Canada Ltd.)* (1985), 5 P.P.S.A.C. 128 (Ont. S.C.) affirmed (1987), 7 P.P.S.A.C. xxxii (note), 64 C.B.R. (N.S.) 80 (note) (Ont. C.A.), and under the new Act in the case of *Adelaide Capital Corp. v. Integrated Transportation Finance Inc.* (1994), 16 O.R. (3d) 414, 6 P.P.S.A.C. (2d) 267 (Gen. Div. [Commercial List]).

36 In discussing the meaning of the "reasonable person" in

the context of the curative section, the court considered the purpose of the search function of the P.P.S.A. registration system (the other function being registration of a security interest for the purpose of perfection and priority). At pp. 120-121 [O.R., pp. 254-55 P.P.S.A.C.] of the decision, the court said:

> In my view, the "reasonable person" in s. 46(4) is a person using the search facilities of the registration system for their intended purpose, that is, to find out whether personal property to be purchased or taken as collateral is subject to prior registered encumbrances. To assess the potential effect of an error in a financing statement one must assume that the property which is the subject of the flawed financing statement is the property targeted by the inquiry made by the prospective purchaser or lender. In this case, therefore, the question becomes – would a potential purchaser of the motor vehicle referred to in the financing statement, or a person considering taking that motor vehicle as security, be materially misled by the error in a previously registered financing statement? This articulation of the test accords with the purpose of the inquiry function of the system, and gives meaning to the requirement that the error be "likely to mislead materially". Unless the effect of the error is addressed in the context of a potential purchase or loan involving the property specified in the financing statement, I am unable to see how an error in that financing statement could be "likely to materially mislead" a prospective purchaser or lender.

37 The question to be decided is did the Roynat registered financing statement perfect its security interest in the motor vehicle inventory of Red Coach because a reasonable person looking at the other information, that is, the fact that the collateral is shown as "motor vehicles" and "other", and is described with a reference to the debenture which, if one looked at it, grants a floating charge over all the property and assets of Red Coach, would not be materially misled by the failure to mark the inventory box.

38 Despite the able argument by Mr. Shanks, in my view, the answer is no. A reasonable person looking at that statement would or at least could believe that Roynat had deliberately chosen to limit its priority to collateral other than inventory, accounts and equipment, but including other motor vehicles, in spite of the all-encompassing nature of the security granted by the debenture. A creditor may have reasons for registering against only certain collateral even where it has security over more.

39 Nor does the Act contemplate that a person searching the register is required to make any inquiry of a registered creditor

as to what collateral is claimed. The register must speak for itself. The system must have certainty and reliability built into it in order to avoid the need to go to court for clarification of priorities. As the Court of Appeal said further in *Re Lambert* [at p. 121 O.R., p. 255 P.P.S.A.C.]:

> The preservation of the integrity of the P.P.S.A. registration system requires that those who use the system for its intended purpose be protected from errors made by other users where those errors are likely to mislead materially.

40 The classification of the collateral perfected by the financing statement is one of the most material effects of the statement and its registration. If the wrong classification box is indicated, there must be other information on the financing statement which clearly and unequivocally designates the collateral perfected by the registration of the financing statement. In this case, there is at best ambiguity, and therefore a reasonable person is likely to be materially misled.

41 Consequently, Roynat did not have a perfected security interest in the motor vehicle inventory of Red Coach at any time.

Issue 7

42 As Roynat did have a perfected security interest in "other" collateral as of September 15 1989, the status of Adelaide's security remains in issue. Adelaide has perfected security in the motor vehicles which were sold to generate the fund as a result of the financing statements registered for each chattel mortgage. However, the fund being held by the receiver includes an amount in excess of the amount outstanding on the chattel mortgages for the particular vehicles sold, although not in excess of the amounts secured by those mortgages. The chattel mortgages provide that the proceeds of sale of the vehicles shall be applied to payment of the amount secured by the mortgage, and that if there is a surplus it shall be paid to the mortgagor "if no other amount is then owing by the mortgagor to the mortgagee".

43 Roynat claims priority on the excess on the basis that although the collateral claimed in the financing statements for each of the chattel mortgages is shown as inventory including motor vehicles, it says that Central Guaranty's claim to priority is limited to the amount outstanding on each vehicle because a description of the charged vehicles is included in the portion of each financing statement available for that information where

the charged vehicles are consumer goods.

44 For this submission Roynat relies on s. 46(3):

> (3) Except with respect to rights to proceeds, where a financing statement or financing change statement sets out a classification of collateral and also contains words that appear to limit the scope of the classification, then, unless otherwise indicated in the financing statement or financing change statement, the secured party may claim a security interest perfected by registration only in the class as limited.

The effect of that section, however, is to limit the class of collateral perfected by a financing statement, but not the debt for which the collateral stands as security.

45 Therefore Adelaide has priority in the proceeds of the sale of the vehicles by virtue of its registration of financing statements in respect of the chattel mortgages covering those vehicles.

Other Issues

46 The other issues deal with Adelaide's other general security from 1986 and 1989 and its status. In light of the findings I have made, it is unnecessary to deal with the other issues. As these issues involve important interpretations and applications of the P.P.S.A. to specific funds, it would be inappropriate to deal with them in *obiter dicta*.

Costs

47 If counsel cannot agree as to costs, brief written submissions may be made.

Order accordingly.

Re Chiips and Skyview Hotels Ltd. et al.

[Indexed as: Chiips Inc. v. Skyview Hotels Ltd.]

Court File No. 14255

Alberta Court of Appeal, Harradence, Hetherington and Foisy JJ.A.
July 15, 1994.

Personal property security — Security interests — Priorities — Lenders taking perfected security interests under debentures — Debentures containing subordination clauses permitting borrower to grant purchase money security interests — Borrower granting purchase money security interest — Seller not perfecting interest by registration until after appointment of receiver — Having priority over lenders — Personal Property Security Act, S.A. 1988, c. P-4.05, s. 40.

The first respondent was a hotel in receivership. The second respondent was the receiver, which was appointed in May, 1992. The other respondents lent moneys to the hotel on the security of debentures issued in 1988. The debentures contained provisions which permitted the hotel to grant purchase money security interests. The appellant sold furniture to the hotel on conditional sale and the hotel granted a purchase money security interest to the appellant in 1991. The appellant did not perfect its security interest by registration of a financing statement until June, 1992. It made a final shipment of furniture to the hotel after the registration. On application, the master held that the appellant had priority over the debenture holders only with respect to the last shipment. The judge below dismissed the appeal.

On further appeal, **held**, Hetherington J.A., dissenting, the appeal should be allowed.

Per Foisy J.A.: The provisions in the debenture were subordination clauses; they allowed the hotel to grant security to its suppliers in the form of purchase money security interests that would have priority over the floating charge in the debentures. Commercial reality also supported this conclusion. Section 40 of the *Personal Property Security Act*, S.A. 1988, c. P-4.05, does not require registration of the subsequent security. Further, it permits a third party, such as the appellant, to enforce the subordination clauses, since the appellant was a person for whose benefit the clauses were intended.

Per Harradence J.A. concurring: Section 40 made it essential to determine whether the clauses were valid subordination clauses. The clauses were subordination clauses, since they purported to give priority to certain later security interests. Further, commercial reality made the ability to grant priority to suppliers in the ordinary course of business necessary. Moreover, registration by the appellant was not contemplated by the debenture holders, since they took their security before the Act was in force.

Per Hetherington J.A. dissenting: The clauses were not subordination clauses. They did not contain either an explicit or an implied waiver of priority. Accordingly the interests of the debenture holders ranked in priority to the interest of the appellant, except in respect of the last shipment.

Euroclean Canada Inc. v. Forest Glade Investments Ltd. (1985), 16 D.L.R. (4th) 289, 54 C.B.R. 65, 4 P.P.S.A.C. 271, 49 O.R. (2d) 769, 8 O.A.C. 1, 29 A.C.W.S. (2d) 421; leave to appeal to S.C.C. refused D.L.R. *loc. cit.*, [1985] 1 S.C.R. viii, 55 C.B.R. (N.S.) xxvii; *Sperry Inc. v. Canadian Imperial Bank of Commerce* (1985),

17 D.L.R. (4th) 236, 55 C.B.R. (N.S.) 68, 4 P.P.S.A.C. 314, 50 O.R. (2d) 267; *C.I.B.C. v. International Harvester Credit Corp. of Canada Ltd.* (1986), 6 P.P.S.A.C. 273; revg 4 P.P.S.A.C. 329; *Transamerica Commercial Finance Corp., Canada v. Imperial T.V. & Stereo Centre Ltd.* (1993), 22 C.B.R. (3d) 297, 6 P.P.S.A.C. (2d) 99, [1994] 1 W.W.R. 506, 146 A.R. 31, 13 Alta. L.R. (3d) 99, 43 A.C.W.S. (3d) 139, **consd**

Other cases referred to

Royal Bank of Canada v. Gabriel of Canada Ltd. (1992), 3 P.P.S.A.C. (2d) 305, 40 A.C.W.S. (3d) 512; *Savin Canada Inc. v. Protech Office Electronics Ltd.* (1984), 8 D.L.R. (4th) 225, 27 B.L.R. 93, 53 C.B.R. (N.S.) 234, 52 B.C.L.R. 20; *Greyvest Leasing Inc. v. Canadian Imperial Bank of Commerce* (1993), 5 P.P.S.A.C. (2d) 187, 43 A.C.W.S. (3d) 466; *Royal Bank of Canada v. Tenneco Canada Inc.* (1990), 66 D.L.R. (4th) 328, 9 P.P.S.A.C. 254, 72 O.R. (2d) 60, 19 A.C.W.S. (3d) 382; *Greenwood Shopping Plaza Ltd. v. Beattie* (1980), 111 D.L.R. (3d) 257, [1980] 2 S.C.R. 228, 10 B.L.R. 234, [1980] I.L.R. ¶1-1243, 39 N.S.R. (2d) 119, 32 N.R. 163, 3 A.C.W.S. (2d) 351; *Subilomar Properties (Dundas) Ltd. v. Cloverdale Shopping Centre Ltd.* (1973), 35 D.L.R. (3d) 1, [1973] S.C.R. 596

Statutes referred to

Business Corporations Act, S.A. 1981, c. B-15

Personal Property Security Act, R.S.O. 1980, c. 375 [repealed 1989, c. 16, s. 84(1)], s. 39

Personal Property Security Act, S.A. 1988, c. P-4.05, ss. 1(1)(*ii*), (*pp*), (*qq*) [rep. & sub. 1990, c. 31, s. 2], 3(1), 23(1) [rep. & sub. *idem*, s. 14], 25, 34(2), 35(1) [am. *idem*, s. 24], 40 [am. *idem*, s. 29], 74(2) [am. *idem*, s. 60], 75(3) [am. 1991, c. 21, s. 29]

APPEAL from a judgment of Mason J., dismissing an appeal from an order of Master Alberstat, determining priorities in a receivership.

Peter S. Jull and *J. Peter McMahon*, for appellant.
Anthony L. Friend, for respondents.

HARRADENCE J.A.:—I have had the advantage of reading the judgments of Foisy J.A. and Hetherington J.A. I agree with the conclusions reached by Foisy J.A. and the reasons he has given. With respect, I would, however, add the following comments.

In light of the wording of s. 40 of the *Personal Property Security Act*, S.A. 1988, c. P-4.05 (P.P.S.A.), it is most important to look at the terms of the purported subordination clause in deciding whether it is indeed a valid subordination clause. Section 40 reads as follows:

> 40. A secured party may, in a security agreement or otherwise, subordinate his security interest to any other interest, and the 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 a class of persons for whose benefit the subordination was intended.

Two cases provide the benchmark against which subordination clauses must be measured and in so doing provide guidance in this

area: *Euroclean Canada Inc. v. Forest Glade Investments Ltd.* (1985), 16 D.L.R. (4th) 289, 54 C.B.R. 65, 4 P.P.S.A.C. 271 (Ont. C.A.) (leave to appeal to the Supreme Court of Canada refused D.L.R. *loc. cit.*, [1985] 1 S.C.R. viii, 55 C.B.R. (N.S.) xxvii) and *Sperry Inc. v. Canadian Imperial Bank of Commerce* (1985), 17 D.L.R. (4th) 236, 55 C.B.R. (N.S.) 68, 50 O.R. (2d) 267 (C.A.) set the standard for interpretation of subordination clauses.

In *Euroclean*, the court considered s. 39 of the Ontario *Personal Property Security Act*, R.S.O. 1980, c. 375, to determine priority between a debenture holder and a subsequent conditional seller. The subordination clause in *Euroclean* reads as follows (at p. 297):

> "(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 in 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."

Euroclean sets a very high standard for subordination clauses. The wording of the *Euroclean* clause contains a very specific waiver of priority. The clause explicitly sets out that purchase money charges "shall" rank in priority.

This clause can be contrasted to the clause set out in *Sperry*. In *Sperry*, the court was asked to consider the following clause in a general security agreement (at pp. 239-40):

> "4. *Ownership of Collateral*
>
> *The undersigned represents and warrants that, except for the security interest created hereby and except for purchase money obligations, the undersigned is, or with respect to Collateral acquired after the date hereof will be, the owner of Collateral free from any mortgage, lien, charge, security interest or encumbrance.* "Purchase money obligations" means any mortgage, lien or other encumbrance upon property assumed or given back as part of the purchase price of such property, or arising by operation of law or any extension or renewal or replacement thereof upon the same property, if the principal amount of the indebtedness secured thereby is not increased."

Counsel for Sperry argued this clause was a valid subordination clause which gave them priority over the bank. The court, however, disagreed and stated (at p. 244):

> As may be gathered from my interpretation of paras. 1 and 4 of the general security agreement I think that the document falls far short of showing an agreement by the bank to subordinate its security interest to that of Sperry.

It is understandable that the court found that this clause "falls far short" of an agreement to subordinate the bank's interest. This

clause is very vague and does not at any point mention the terms "rank" or "priority".

From the above cases, the parameters are clear. An explicit and specific waiver clearly gives rise to a valid subordination clause. A vague and non-specific clause is not to be construed as a subordination clause. The question that arises is simply where on the continuum do the purported subordination clauses in the case at bar lie?

The clauses which the appellant relies on read as follows:

> 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 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 on property 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 thereon 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; . . .

(Emphasis added.)

The respondent argues these clauses do not specifically give priority to the appellant and therefore no effect should be given to them. The respondent argues that because the wording does not

meet the high standard set by *Euroclean*, these clauses do not constitute valid subordination clauses. The clauses, it is argued, merely permit Skyview to give security for purchase money.

These clauses are not as specific as those 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. The present situation is one that is contemplated by this 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. For example cl. 6.01 sets out that an encumbrance shall not be created that ranks in priority. It then creates an exception using the following language:

> ... provided, however, that this covenant shall not apply to, or operate to prevent, and there shall be permitted:
>
> i) the assuming or giving of purchase money mortgages or other purchase money liens on property acquired by the Company ... .

The exception set out is exactly the situation that has arisen in the present case. The debenture holders by using this language are not only permitting Skyview to create such charges, they are clearly acknowledging that these charges rank ahead in priority. With respect, any other interpretation would render the exception devoid of any practical meaning.

The cases cited by counsel for both the appellant and respondents, other than *Euroclean* and *Sperry*, add little to this analysis. However, *C.I.B.C. v. International Harvester Credit Corp. of Canada Ltd.* (1986), 6 P.P.S.A.C. 273 (Ont. C.A.), provides some insight into interpreting a clause of this nature. The subordination clause being considered in *C.I.B.C. v. International Harvester* is identical to cl. 4.05 in the debentures. The trial judge gave effect to the subordination clause but was overturned by the Court of Appeal on the grounds that the subordination clause did not affect fixed charge security. Brooke J.A. of the Court of Appeal stated (at p. 276): "I think the subordination clause is limited to the floating charge."

Neither court did an analysis of the subordination clause, however, both courts accepted this clause to be a subordination

clause. It was not an issue at the trial or Court of Appeal level whether this clause was indeed a valid subordination clause. Nor did the bank, the drafters of this clause, ever challenge this as an invalid subordination clause. The Ontario Court of Appeal in reversing the lower court's decision at all times referred to this clause as a subordination clause. When one considers that in the present case only a floating charge is at issue, the logical conclusion is that the subordination clause found in this debenture should be declared valid.

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 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 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.

Conclusion

In summary, s. 40 of the P.P.S.A. specifies that a subordination clause is given effect according to its terms. As pointed out, the terms of this clause are not as specific as those in *Euroclean*. The terms are however much more specific and clear than those in *Sperry*. This clause, by its terms, contemplates the subordination of the debenture holder's interests. It, at the very least, impliedly

allows suppliers, such as the appellant Chiips, to rank ahead of the debenture holders in regards to the goods supplied. Again, commercial reality requires that documents of this nature be given effect. For these reasons, the appeal should be allowed and the funds set aside should be released to the appellant.

HETHERINGTON J.A. (dissenting):—The respondents B.C. Central Credit Union, Banque Laurentienne du Canada, Societe General (Canada), Roynat Inc., ABN AMRO Bank Canada and the Bank of Tokyo Canada hold five debentures issued by the respondent, Skyview Hotels Limited. The wording of the debentures is identical. Under the debentures Skyview gave these respondents, as holders of the debentures, floating charges on all of its property, present and future, except that which was subject to fixed charges under the debentures. These floating charges were to secure payment of the sums of money referred to in the debentures, as well as performance of the obligations of Skyview under the debentures.

Subsequently the appellant, Chiips Inc., supplied goods to Skyview pursuant to an agreement which provided that the ownership of the goods would remain with Chiips until they were paid for in full.

Skyview defaulted under the debentures. The debenture holders then applied to a master of the Court of Queen's Bench for an order appointing the respondent Ernst & Young Inc. receiver and manager of all of the existing and future assets of Skyview. The master granted this order.

Skyview also failed to pay Chiips in full for the goods supplied under the agreement referred to above.

Later the assets of Skyview were sold. The judge of the Court of Queen's Bench who approved this sale ordered that Ernst retain the sum of $312,589, such sum to "stand in the stead of" the goods claimed by Chiips, that is, the goods which it had supplied to Skyview.

Chiips contends that its security interest in the money held by Ernst in place of these goods, has priority. It relies on what it says are subordination clauses in the debentures. The debenture holders claim that their security interests in this money have priority. These competing claims must be reconciled in accordance with the provisions of the *Personal Property Security Act*, S.A. 1988, c. P-4.05.

The chronology of the events described above and others is important in this case. I will set it out below:

1988	
January 31	Skyview issued debentures.
February 29	Debentures registered at corporate registry under the *Business Corporations Act*, S.A. 1981, c. B-15.
1990	
October 1	*Personal Property Security Act* came into force.
October 1	Security interests of debenture holders deemed to have been registered and perfected under the *Personal Property Security Act* (s. 75(3)).
1991	
November 14	Chiips entered into agreement in writing to supply goods to Skyview.
December	First load of goods sent by Chiips to Skyview.
1992	
January to March	Many loads of goods sent by Chiips to Skyview.
May 14	Ernst appointed receiver and manager of assets of Skyview.
June 5	Chiips perfected its purchase money security interest in goods supplied under its agreement with Skyview by registering a financing statement at the Personal Property Registry, in accordance with s. 25 of the *Personal Property Security Act*.
June 23	Registration of security interests of debenture holders continued by filing of financial statements at Personal Property Registry under s. 23(1) and s. 25 of the *Personal Property Security Act*.
July 14	Skyview received final shipment of goods from Chiips.
1993	
January 28	Chiips applied to master of Court of Queen's Bench for determination of priority.
April 7	Chiips appealed from order of master to judge of Court of Queen's Bench.
July 30	Sale of assets of Skyview approved.

On January 28, 1993, Chiips applied to the master for an order

— determining that it had priority and was entitled to the goods which it had supplied to Skyview, and

— for permission to enforce its security by repossessing and removing the goods from the premises of Skyview.

The master found that Chiips had security and priority only in relation to the goods which Skyview received on July 14, 1992. He gave Chiips permission to enforce this security by repossessing and removing these goods from the premises of Skyview. Chiips

appealed from this order to a judge, who dismissed the appeal. It appealed again to this court.

There is no doubt that the *Personal Property Security Act* applies to the transactions in question in this case. Section 3(1) of the Act says:

> 3(1) Subject to section 4, this Act applies to
>
> (*a*) every transaction that in substance creates a security interest, without regard to its form and without regard to the person who has title to the collateral, and
>
> (*b*) without limiting the generality of clause (*a*), a ... conditional sale, floating charge, ... where they secure payment or performance of an obligation.

Section 4 is not relevant.

Both Chiips and the debenture holders had security interests in the goods which Chiips supplied to Skyview, according to the definition of a "security interest" in s. 1(1)(*qq*) of the Act. Their interests secured payment, and in the case of the debenture holders, performance of obligations. In addition, the sale of the goods by Chiips to Skyview was a conditional sale, and the respondent debenture holders had a floating charge on these goods. Therefore, under both cl. (*a*) and cl. (*b*) of s. 3(1), the dealings of Chiips and the debenture holders in relation to the goods supplied by Chiips to Skyview come under the Act.

It is true that the *Personal Property Security Act* did not come into force until October 1, 1990, and Skyview issued the debentures on January 31, 1988. However, s. 74(2)(*a*) and (*b*) of the Act say that it applies to every security agreement and every security interest not validly terminated in accordance with the prior law before October 1, 1990. The debentures are security agreements according to the definition of a security agreement in s. 1(1)(*pp*) of the Act. It is not suggested that they were validly terminated before October 1, 1990.

The question is — which security interest or interests, that of Chiips or that of the debenture holders, has priority under the Act?

The security interest of Chiips is a "purchase money security interest" as that phrase is defined in s. 1(1)(*ii*). To the extent that Chiips met the requirements of s. 34(2) when it perfected its purchase money security interest by registering a financing statement, it has priority over any other security interest in the money standing in the stead of the goods. The relevant parts of s. 34(2) read as follows:

34(2) A purchase-money security interest in

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

. . . . .

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

Chiips supplied many loads of goods to Skyview before the end of March, 1992. However, it did not register a financing statement until June 5, 1992. In doing so it perfected its purchase money security interest, but not within the time stipulated in s. 34(2). It cannot, therefore claim priority under s. 34(2) in relation to goods supplied before the end of March, 1992.

Chiips supplied one load of goods to Skyview after it registered its financing statement. That load was delivered on July 14, 1992. The master found that Chiips had priority in relation to these goods. The judge did not vary this finding, and the debenture holders have not appealed from it. It appears, therefore, that it is not disputed that Chiips' security interest in the money held by Ernst has priority to the extent of the value of this shipment.

So far as the bulk of the goods supplied by Chiips to Skyview is concerned, Chiips cannot claim priority under s. 34(2). It is necessary, therefore, to see what other sections of the Act apply.

Section 35(1) of the Act contains residual priority rules. The relevant parts of it read as follows:

35(1) Where this Act provides no other method for determining priority between security interests,

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

(i) the registration of a financing statement, without regard to the date of attachment of the security,

. . . . .

. . . , or

(iii) perfection under section . . . 75,

whichever is earlier,

Under s. 75(3) the security interests of the debenture holders were deemed to have been registered and perfected when the Act came into force on October 1, 1990. The debenture holders filed financial statements on June 23, 1992, before the registered and perfected status of the security interests ceased to be effective under s. 75(3). The security interests were therefore continuously perfected (ss. 23(1), 25 and 75(3)). Chiips did not perfect its security interest until it registered a financial statement on June

5, 1992. The debenture holders appear, therefore, to have priority pursuant to s. 35(1) of the Act.

Counsel for Chiips argued, however, that each of the debentures contained clauses which in effect subordinated the security interest of the debenture holder to that of Chiips. It is not clear that at common law Chiips could rely on these clauses, because it is not a party to the contracts in which they are found, that is, the debentures. Authority for the proposition that it cannot is found in *Greenwood Shopping Plaza Ltd. v. Beattie* (1980), 111 D.L.R. (3d) 257, [1980] 2 S.C.R. 228, 10 B.L.R. 234, and in *Euroclean Canada Inc. v. Forest Glade Investments Ltd.* (1985), 16 D.L.R. (4th) 289 at p. 300, 54 C.B.R. 65, 4 P.P.S.A.C. 271 (Ont. C.A.) (leave to appeal to S.C.C. refused D.L.R. *loc. cit.*, [1985] 1 S.C.R. viii, 55 C.B.R. (N.S.) xxvii. *Savin Canada Inc. v. Protech Office Electronics Ltd.* (1984), 8 D.L.R. (4th) 225, 27 B.L.R. 93, 53 C.B.R. (N.S.) 234 (B.C.C.A.), a contest between the holders of two different debentures, would appear to be authority to the contrary. However, the right of one debenture holder to rely on clauses in a debenture held by another was not discussed in the judgment, nor was the *Greenwood* case referred to.

In any event, priority in this case must be determined, not under the common law, but under the *Personal Property Security Act*. Section 40 of the Act reads as follows:

> 40. A secured party may, in a security agreement or otherwise, subordinate his security interest to any other interest, and the 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 a class of persons for whose benefit the subordination is intended.

In *Euroclean* the court considered (at pp. 299-302) the corresponding section in the *Personal Property Security Act*, R.S.O. 1980, c. 375, then in effect in Ontario, that is s. 39. That section read as follows:

> 39. A secured party may, in the security agreement or otherwise, subordinate his security interest to any other security interest.

In *Euroclean* Mr. Justice Houlden, writing for the court, concluded at pp. 301-2:

> In my opinion, s. 39 is intended to confer a statutory right on a secured party to waive the priority given him by the P.P.S.A. and to confer a corresponding right on the beneficiary of such a waiver to enforce it, even though he is not a party to the agreement which created it or has no knowledge of its existence.

The effect of s. 40 of the Alberta Act is the same as that of s. 39 of the Ontario Act referred to above. Two questions must then be answered. First, did the debenture holders waive the priority given to them by the Alberta Act? Second, is Chiips the person or

one of a class of persons for whose benefit the waiver was intended?

The clauses on which counsel for Chiips relied are the following (A.B. at pp. 38 and 42-3):

> 4.05 *Possession, Use and Release of Mortgaged Property*
>
> ... 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 or any extension or renewal or replacement thereof upon the same property if the principal amount of the indebtedness secured thereby is not increased; or
>
> . . . . .
>
> 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 on property acquired by the Company or the giving of mortgages or liens in connection with the acquisition or purchase of such property ...

Clearly these clauses do not contain an explicit waiver of priority. They are, for example, quite different from the clause in question in *Euroclean*. It read as follows (at p. 297):

> "(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.*"

(Emphasis added.)

It is not surprising that the court in *Euroclean* found this to be a subordination clause (at p. 299). The part of it which is

emphasized above contains a clear and explicit waiver of priority. There is no such explicit waiver in the clauses in question in this case.

Do these clauses give rise to an implied waiver of priority by the debenture holders? In my view they do not.

In each debenture the exception in cl. 4.05(a) and the proviso in cl. 6.01(c)(i) are permissive. They permit Skyview to assume or to give security for purchase money, which security ranks or is capable of being enforced in priority to or *pari passu* with, among other things, the floating charge. If it were not for this exception and proviso, the assuming or giving of such security by Skyview would constitute a breach of the covenants made by it in these clauses, and an event of default under the debenture. There is nothing in the clauses to suggest any intention on the part of the debenture holders to go further than to permit the assuming or giving of such security. Nor was anything further required to permit Skyview to carry on business.

There is nothing in these clauses to suggest that security for purchase money will rank or be capable of being enforced in the manner described because of any waiver on the part of the debenture holders. Nor is there anything to suggest that where security for purchase money does not rank or is not capable of being enforced in priority to or *pari passu* with, among other things, the floating charge, which is the case here, the debenture holder waives any of its rights. I do not see how any waiver of priority can be implied in these clauses.

Beyond that, the priority with which we are concerned is priority under the *Personal Property Security Act*. Skyview issued the debentures in which the clauses in question are found on January 31, 1988. The *Personal Property Security Act* was not assented to until July 6, 1988. It did not come into force until October 1, 1990. No doubt on January 31, 1988, the debenture holders could have waived any right to priority which they might have in the future. However, they did not do so explicitly, and I do not think that such a waiver can be implied from the clauses quoted above.

Since in my view the debenture holders did not waive any priority given to them by the Act, it is not necessary for me to consider whether Chiips is the person or one of a class of persons for whose benefit the waiver was intended.

I will deal briefly with the cases relied on by counsel. Counsel for Chiips referred us to the *Euroclean* case, which I have already discussed, and to *C.I.B.C. v. International Harvester Credit Corp. of Canada Ltd.* (1986), 6 P.P.S.A.C. 273 (Ont. C.A.). In that case

the trial court (4 P.P.S.A.C. 329 (Ont. H.C.J.)) and the Court of Appeal were required to consider a clause which was almost identical to cl. 4.05 quoted above. It appears that both at trial and on appeal it was assumed that it was a subordination clause. The trial judge found that it applied to the trucks in question even though they formed part of the fixed charge. The Court of Appeal disagreed. It was of the view that the clause only applied to the floating charge, and did not therefore apply to the trucks. In these circumstances the Court of Appeal did not need to decide whether the clause was in fact a subordination clause, and did not discuss this question.

Counsel for Chiips also referred us to *Transamerica Commercial Finance Corp., Canada v. Imperial T.V. & Stereo Centre Ltd.* (1993), 22 C.B.R. (3d) 297, 6 P.P.S.A.C. (2d) 99, 146 A.R. 31 (Q.B.). In that case Madam Justice Nash was required to interpret a clause which she described as follows (at p. 299):

> Imperial, by the terms of the Debenture, agreed not to assume any other charges against the assets of the company, without the prior written consent of the Credit Union, that would have priority over the Credit Union's debenture unless, *inter alia* (The Subordination Clause):
>
> > "The same be given to or in favour of the bankers of [Imperial] on the security of the accounts receivable or the inventory of [Imperial] to secure current loans required for the usual purposes of the business of [Imperial] and whether given pursuant to the provisions of the Bank Act or otherwise."

Madam Justice Nash found this to be a subordination clause (at p. 302). In doing so she relied on *Euroclean*. She found that the above clause was similar to the clause under consideration in that case. With respect, I do not agree. The clause in question in *Euroclean* contained an explicit waiver of priority. The one quoted above does not.

Counsel for the debenture holder referred us to *Sperry Inc. v. Canadian Imperial Bank of Commerce* (1985), 17 D.L.R. (4th) 236, 55 C.B.R. (N.S.) 68, 50 O.R. (2d) 267 (C.A.). In that case the court was required to interpret the following clause in a general security agreement (at pp. 239-40):

> "4. *Ownership of Collateral*
>
> *The undersigned represents and warrants that, except for the security interest created hereby and except for purchase money obligations, the undersigned is, or with respect to Collateral acquired after the date hereof will be, the owner of the Collateral free from any mortgage, lien, charge, security interest or encumbrance.* 'Purchase money obligations' means any mortgage, lien or other encumbrance upon property assumed or given back as part of the purchase price of such property, or arising by operation of law or any extension or renewal or replacement thereof upon the same property,

> if the principal amount of the indebtedness secured thereby is not increased."

(Emphasis added by Ontario court.) In that case Mr. Justice Morden, writing for the court, referred to extrinsic evidence on which the trial judge had relied, and concluded (at p. 244):

> Sperry also submitted that the evidence disclosed an agreement by the bank to subordinate its security interest to that of Sperry. An agreement of this kind is recognized by s. 39 of the Act. As may be gathered from my interpretation of paras. 1 and 4 of the general security agreement I think that the document falls far short of showing an agreement by the bank to subordinate its security interest to that of Sperry. Contrast the terms in the debenture in *Euroclean* . . . .

I agree with counsel for the debenture holders that this case is analogous to the one before us.

After considering these cases, and for the reasons set out above, it is my view that the debenture holders did not, in the clauses in the debentures on which Chiips relies, waive their priority under the *Personal Property Security Act*. They did not subordinate their security interests to any other security interest. Under s. 35(1) of the Act, therefore, their security interests in the money held by Ernst in place of the goods supplied by Chiips to Skyview, has priority.

I would therefore dismiss the appeal.

FOISY J.A.:—

Facts

The respondents in this appeal are: Skyview Hotels (in receivership); Ernst & Young Inc. (the receiver); and a group of companies holding five mortgages and debentures (all dated January 31, 1988) against the real and personal property of Skyview.

The mortgages and debentures are in the aggregate principal sum of $25 million. They contain a fixed charge on lands and fixtures, and a floating charge on all other assets. A representative sample of these instruments is reproduced at p. 32 of the Appeal Book. The mortgages and debentures were registered in the corporate registry on February 29, 1988. As a result of the enactment of the *Personal Property Security Act*, S.A. 1988, c. P-4.05 (hereinafter P.P.S.A.), these interests were reregistered in the personal property registry on June 23, 1992. *Per* s. 75(3) of the P.P.S.A. these interests were perfected and maintained their February 29, 1988 registration date.

The appellant, Chiips Inc., was a supplier for the refurnishing of six floors of the Skyline Plaza Hotel pursuant to a conditional sales agreement dated November 14, 1991. Skyview paid for the goods

using 16 post-dated cheques, each in the amount of $38,197.01, to be used as a security deposit toward the contract. The appellant shipped a number of loads of furniture between December of 1991 and March of 1992.

On May 14, 1992, a receivership order was granted as a result of a default by Skyview under the mortgages and debentures. Ernst & Young was appointed receiver and manager. The appellant received notice of this order on May 19, 1992, and gave notice to the receiver on May 21, 1992, when Skyview failed to pay for the goods supplied by the appellant. The amount outstanding at that date was $257,163.58.

On June 5, 1992, the appellant filed a financing statement under the P.P.S.A. with respect to its conditional sales agreement. One last load of furniture was shipped after the registration of the financing statement; that shipment was received on July 14, 1992. The respondents were not aware of the fact that the appellant had not perfected its security interest prior to the receivership order.

At the initial priority dispute which was heard by Master Alberstat on January 28, 1993, Chiips argued that s. 40 of the P.P.S.A. gave it priority due to certain purported subordination clauses in the mortgages and debentures. The response to this was that the debenture holders' reregistration gave them priority as perfection dated back to February 29, 1988. Master Alberstat determined that the debenture holders had priority to all but the last shipment (the fact that Chiips had registered its security interest prior to the last shipment resulted in "super priority" because the charge was in the nature of a purchase money security interest *per* s. 34 of the P.P.S.A.). On April 7, 1993, an appeal to the justice was dismissed with costs.

Pursuant to the order of Justice Moshansky granted on July 30, 1993, the Hotel has been sold by the receiver, and a portion of the proceeds, $312,589, has been set aside pending the determination of this appeal. The issue in this appeal is the priority between the holder of a fixed and floating charge debenture and the vendor under what is essentially a conditional sales contract.

The appellant submits that the chambers judge erred in failing to give effect to the subordination provisions and failing to give effect to s. 40 of the P.P.S.A. The respondents submit that the provisions in question do not have the effect of subordinating the claim of the debenture holders and thus s. 40 has no application here.

Analysis

A. *Subordination clauses as contemplated by the P.P.S.A.*

Section 40 of the P.P.S.A. specifically provides for the use of subordination clauses in security agreements. The section reads as follows:

> 40. A secured party may, in a security agreement or otherwise, subordinate his security interest to any other interests and the 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 a class of persons for whose benefit the subordination was intended.

This provision of the Act is very important as it allows debtors to carry on their businesses effectively. The significance of the section lies in the fact that, under the P.P.S.A. regime, it is relatively simple for a secured creditor to take and perfect a very broadly based security interest: Cuming & Wood, *Alberta Personal Property Security Act Handbook*, 2nd ed. (Toronto: Carswell, 1993) at p. 301. Because the debtor has to be given some ability to carry on business (*e.g.* acquire goods on credit), the Act allows a secured creditor to subordinate its interest to other creditors with whom the debtor must deal on an ongoing basis. The reasoning behind the enactment of s. 40 was succinctly stated by Philp J. in *Royal Bank of Canada v. Gabriel of Canada Ltd.* (1992), 3 P.P.S.A.C. (2d) 305 at p. 309, 40 A.C.W.S. (3d) 512 (Ont. Ct. (Gen. Div.)): "... s.38 of the P.P.S.A. conferred a statutory right on a secured party to waive the priority given him by the P.P.S.A. and a corresponding right on the beneficiary of such a waiver ... to enforce it."

Because of the provision for subordination clauses, the Act will not prevent a subsequent credit grantor from claiming priority over a prior secured creditor where the latter has agreed to subordinate its claim. The question is whether the alleged subordination clause actually had that effect.

B. *What is the effect of cls. 4.05 and 6.01(c) of the debentures?*

The appellant argues that the debentures contained subordination clauses which validly gave Chiips priority over the debenture holders pursuant to s. 40. There are two clauses in the debenture agreements which the appellant says amount to subordination clauses; they read as follows (A.B. pp. 38, 42-3):

> 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 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 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 on 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 on property 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 thereon 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; . . .

In order to determine whether the above clauses amount to subordination on the part of the debenture holders as contemplated by s. 40, it is useful to refer to two Ontario decisions. The decisions in question are helpful yet not determinative; in both cases the court analyzes clauses to determine whether an interest is subordinated, but both clauses are different from the clauses in the case at bar.

In *Euroclean Canada Inc. v. Forest Glade Investments Ltd.* (1985), 16 D.L.R. (4th) 289, 54 C.B.R. 65, 4 P.P.S.A.C. 271 (Ont. C.A.) (the Supreme Court of Canada refused leave to appeal on June 3, 1985 [reported D.L.R. *loc. cit.*, [1985] 1 S.C.R. viii, 55 C.B.R. (N.S.) xxxvii]) the court was asked to determine priorities between a debenture holder and a subsequent conditional seller who had failed to register his interest. The debenture contained the following clause which the court found had the effect of giving priority to the conditional seller (at p. 297):

"(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 in 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.*"

(Emphasis added.) Houlden J.A., at p. 299, decided that the conditional sale by Euroclean gained priority over the debenture as a result of the above clause:

> By cl. (e), Brazier was permitted to give mortgages or liens in connection with the acquisition of property .... The purchase of the laundry equipment from Euroclean clearly comes within this wording; and if property is acquired in this way, the subordination clause provided that the mortgage, lien or other encumbrance is to rank in priority to the charge created by the debenture.

and at p. 302:

> Euroclean, by reason of s.39, is, in my opinion, entitled to enforce the provisions of cl. (e) against Mady and, consequently, is entitled to priority over Mady's security interest.

The respondents in the case at bar argue that s. 40 makes it clear that the wording of any purported subordination clause is critical in assessing the rights of the parties. The decision of *Euroclean* is used to support this position as the clause in that case makes it abundantly clear that purchase money charges "shall" rank in priority to the debenture. The respondent puts forward the case of *Sperry Inc. v. Canadian Imperial Bank of Commerce* (1985), 17 D.L.R. (4th) 236, 55 C.B.R. (N.S.) 68, 50 O.R. (2d) 267 (C.A.), in support of its argument that case law indicates that nothing short of a clause like the one in *Euroclean* will act to validly subordinate the prior creditor's claim.

The priority dispute in *Sperry* was between a bank holding a general security interest with an equipment dealer and a manufacturer/supplier of farm equipment who had a prior registered security interest with the dealer. Both of the creditor's registrations lapsed and the bank claimed that it had priority because their security interest re-attached before the supplier had renewed its financing statement. The bank's security agreement contains the following clauses (at pp. 239-40):

> "1. As a general and continuing collateral security for payment of all existing and future indebtedness and liability of the undersigned [Allinson] to Canadian Imperial Bank of Commerce (the 'Bank') wheresoever and howsoever incurred and any ultimate unpaid balance thereof, *the undersigned hereby charges in favour of and grants to the Bank a security interest*

in the undertaking of the undersigned and all property of the kinds hereinafter described of which the undersigned is now or may hereafter become the owner and which, insofar as the same consists of tangible property, is now or may hereafter be in the place or places designated in paragraph 14 hereof; and the undersigned agrees with the Bank as hereinafter set out.

. . . . .

"4. *Ownership of Collateral*

The undersigned represents and warrants that, except for the security interest created hereby and except for purchase money obligations, the undersigned is, or with respect to Collateral acquired after the date hereof will be, the owner of Collateral free from any mortgage, lien, charge, security interest or encumbrance. 'Purchase money obligation' means any mortgage, lien or other encumbrance upon property assumed or given back as part of the purchase price of such property, or arising by operation of law or any extension or renewal or replacement thereof upon the same property, if the principle amount of the indebtedness secured thereby is not increased."

Though the result was in favour of the equipment supplier on other grounds, the court, *per* Morden J.A., at pp. 243-4, held that the above clauses in the bank's general security agreement fell far short of showing an agreement by the bank to subordinate its security interest to that of the supplier. The learned appeal justice supported this finding using the specific wording in the subordination clause found in *Euroclean*.

Looking at these two cases as outlined above, we are not in much better a position for determining whether the clauses in the case at bar amount to a valid subordination of the debenture holders' interests to the conditional seller. The subordination clause in *Euroclean* was included in the security agreement for the express purpose of putting the interest of a purchase money security holder ahead of the interests of the debenture holders. The court found this to be the intention based on the clear and unambiguous wording of cl. (e). Conversely, the court in *Sperry* found that the clauses fell far short of the clear and unambiguous wording of the clause in *Euroclean*, and were therefore not read as having the effect of subordinating the bank's interest to that of the supplier.

Given the above two decisions, we know two things: first, where a general security holder specifically states that a subsequent security holder "shall rank in priority to the charge hereby created", that subsequent holder will be entitled to enforce the provisions of that agreement *per* s. 40 of the P.P.S.A. Second, clauses in security agreements which fall far short of that type of express wording (for example the impugned clauses in *Sperry* did

not even mention the word "priority") will not be enforceable under s. 40.

These decisions represent opposite ends of a spectrum: at one end we have a clause directing exactly who will be given priority and, at the other, a clause which mentions nothing about priority. Consequently we are left with very little direction as to what should result in cases where the alleged subordination clauses fall somewhere in between, as in the case at bar. We therefore look to other authority, which, though not directly deciding the point, address it none the less. There are a number of cases which are of assistance in this regard; they are outlined below.

The discussions of the courts in the following two cases lead to a positive inference by this court that the alleged subordination clause in the case at bar acts to validly give priority to Chiips.

The case of *C.I.B.C. v. International Harvester Credit Corp. of Canada* (1986), 6 P.P.S.A.C. 273 (Ont. C.A.), involved a debtor who had entered into a fixed and floating charge debenture with C.I.B.C. Later, the debtor entered into a conditional sales agreement for nine trucks. Both security interests were registered, but the bank's registration preceded the vendor's. At trial the vendor was given priority over the trucks because there were subordination clauses in the bank's security agreement. The clauses were virtually identical to the clauses in this case; they read as follows (at pp. 274-5):

> "2.1 As security for the due payment of all moneys payable hereunder, the Corporation as beneficial owner hereby:
>
> "(a) grants, assigns, conveys, mortgages and charges as and by way of a first fixed and specific mortgage and charge to and in favour of the Bank, its successors and assigns all machinery, equipment, plant, vehicles, goods and chattels now owned by the Corporation and described or referred to in Schedule A hereto and all other machinery, equipment, plant, vehicles, goods and chattels, hereafter acquired by the Corporation; and
>
> "(b) charges as and by way of a first floating charge to and in favour 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 including, without limitation, its franchises.
>
> "In this Debenture, the mortgages and charges hereby constituted are called the 'Security' and the subject matter of the Security is called the 'Charged Premises'
>
> "*2.2 Until the Security becomes enforceable, the Corporation 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 Corporation 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 principle amount of the indebtedness secured thereby is not increased, or any inchoate liens for taxes or assessments by public authorities."

(Emphasis added.)

The italicized portion of cl. 2.2 above is the same as cl. 4.05 in the case at bar. At trial the learned judge held that by reason of ss. 2.1 and 2.2 of the debenture, the bank had subordinated its security interest to the seller (4 P.P.S.A.C. 329 at p. 336). The appellate court allowed the bank's appeal based on the fact that the trucks in question were the subject of the fixed charge as stated specifically in sch. A of the debenture agreement; the subordination clause only applied to the floating charge. In overturning the lower court's decision, Brooke J.A. states the following (at p. 276):

> In my opinion, the subordination provision in the debenture does not apply to the nine trucks as they form part of the fixed charge. I think the subordination clause is limited to the floating charge which, it is conceded, did not apply to the trucks. While the drafting of the clauses leaves much to be desired, I think it makes provision only as to the manner of the floating charge until it becomes enforceable. For that period of time it provides that Prospect can deal with the subject matter of the floating charge in the ordinary course of its business provided that it cannot encumber any part of that property except where necessary to finance the purchase of its property and then only to the extent provided for in the clause.

The second case, a recent decision of the Alberta Court of Queen's Bench, is *Transamerica Commercial Finance Corp., Canada v. Imperial T.V. & Stereo Centre Ltd.* (October 12, 1993), Edmonton No. 9303-12285 (Q.B.) [now reported 22 C.B.R. (3d) 297, 6 P.P.S.A.C. (2d) 99, [1994] 1 W.W.R. 506]. That case involved a determination of priority between the holder of a floating charge debenture and the holder of a purchase money security instrument. The subordination clause was outlined by Nash J. as follows (at p. 2) [p. 299 C.B.R.]:

> Imperial, by the terms of the Debenture, agreed not to assume any other charges against the assets of the company, without the prior written consent of the Credit Union, that would have priority over the Credit Union's debenture unless, *inter alia* (The Subordination Clause):
>
> > "The same be given to or *in favour of the bankers of [Imperial]* on the security the accounts receivable or the inventory of [Imperial] to secure current loans required for the usual purposes of the business of [Imperial] and whether given pursuant to the provisions of the Bank Act or otherwise."

(Emphasis added.)

The court accepted the decision of the Court of Appeal in Ontario in *Euroclean* and applied it in giving effect to subordination clauses where applicable. However, the subordination clause outlined above only applied where the party giving new credit was a bank; Transamerica was held not to be a bank. The following finding is made in relation to that point (at p.10) [p. 304 C.B.R.]:

> When the subordination clause is given its plain and ordinary meaning, I am satisfied that the parties to the Debenture intended that "bankers" not mere "creditors" or "lenders" were to be entitled to enforce the subordination clause and rank above or equal to the Credit Union.

It would therefore appear, from the above cases, that the Ontario Court of Appeal and the Alberta Court of Queen's Bench accept that subordination clauses can be enforced against the prior security holder if the collateral in question is subject to that subordination (*International Harvester*) and if the subsequent creditor is of the kind contemplated in the subordination clause (*Transamerica*).

Applying these cases here, it is my view that the clauses in the debenture are subordination clauses; the only questions remaining are whether the furniture was subject to the subordination, and whether Chiips was the kind of creditor that was contemplated by the clause. The furniture is certainly the subject of the floating charge rather than the fixed charge as indicated by cl. 4.01 which outlines the security taken by the debenture holders. Further, the subordination clauses in the debenture agreement are silent with respect to who the subsequent creditor might be; if the debenture holders had intended to limit the granting of priority to a particular group of creditors, they should have outlined this limitation in the agreement. As no such limitation exists it is open for this court to find that the subordination clause may be enforceable by Chiips as against the debenture holders.

The policy rationale for finding that the clauses in question should be enforceable by Chiips is one of commercial reality. The whole purpose for including these kinds of clauses in security agreements is to "remove any obstacles the debtor might encounter in acquiring new collateral for the conduct of his business": see Ziegel, "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.B.L.J. 367 at p. 372. Clauses such as those in this case are intended to confer priority on purchase money security interests; without this clause the debtor would not be able to purchase goods on credit as the potential creditor would not be able to get any sort of security from the debtor.

I think it is clear that the clauses gave Skyview the right in the ordinary course of business to grant security to its suppliers (in the form of purchase money security interests) which would have priority over the floating charge in the debentures. At the time the debentures were granted, the law was clear that the language used in the debentures acted to subordinate the floating charge to a conditional sale or purchase money charge: see *Savin Canada Inc. v. Protech Office Electronics Ltd.* (1984), 8 D.L.R. (4th) 225, 27 B.L.R. 93, 53 C.B.R. (N.S.) 234 (B.C.C.A.); the debenture holders ought to have known then that the provisions had that effect. Clearly, the parties intended that the floating charge would be subordinated to allow Skyview to carry on its business.

It is interesting to note that it is possible under the Act to prove a subordination in fact without the existence of a specific subordination agreement: see *Greyvest Leasing Inc. v. Canadian Imperial Bank of Commerce* (October 28, 1993), Toronto No. C11119 (Ont. C.A.) [now reported 5 P.P.S.A.C. (2d) 187, 43 A.C.W.S. (3d) 466], and *Royal Bank of Canada v. Tenneco Canada Inc.* (1990), 66 D.L.R. (4th) 328, 9 P.P.S.A.C. 254, 72 O.R. (2d) 60 (H.C.J.). I do not need to discuss this possibility here because the subordination clauses themselves are enough to give Chiips priority over the debenture holders with respect to the furniture supplied.

Having found that the clauses in the case at bar amount to a valid subordination of the debenture holders' interests, it is now necessary to decide two issues: whether the lack of registration on the part of Chiips affects the subordination agreements, and whether the fact that Chiips was not a party to the debenture agreements has any affect on the enforceability of the subordination clauses.

C. *Does s. 40 require registration?*

This issue was examined very carefully in *Euroclean* with the majority of the court holding that registration is not necessary in the enforcement of a subordination agreement. Houlden J. referred to an academic comment by Ziegel, *op. cit.*, which was a case comment on the lower court decision. In that article at p. 372, Ziegel made the following criticism of the trial judge's findings:

> Fitzpatrick J. went on to hold however that cl. (e) also conferred no priority on Euroclean's security interest unless it had been perfected in time. This is a much more debatable conclusion. The learned judge said:
>
> > "I find that there was nothing in the provision or elsewhere which rebutted the presumption that the parties intended Mady's security interest to attach, nor does the provision give priority to Euroclean's security interest. The fact that Brazier was permitted by the debenture it gave to Mady to take the equipment from Euroclean, subject to a

> security interest which would have ranked ahead of Mady's had it been registered in time, does not give any priority to Euroclean's security interest when it was not registered in time."
>
> There are several difficulties about this passage. First, it reads into cl. (e) a requirement of registration not to be found in it. Had there been such a requirement cl. (e) would have conferred no benefit on Euroclean since Euroclean would have been entitled to priority in any event pursuant to s. 34(3) of the OPPSA. Second, the court's reasoning ignores the purpose of cl. (e) ... cl. (e) is intended to confer priority on purchase money security interests ("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.

The appellate court agreed with Ziegel's analysis of the trial judgment. The court specifically finds, at p. 300, that the failure to make timely registration does not affect the claimant's right to enforce a subordination clause. This finding of the Ontario Court of Appeal was adopted by Nash J. in *Transamerica* at p. 8 [p. 302 C.B.R.].

This situation in the case at bar is very similar to the facts in *Euroclean*: there was no requirement in the subordination clauses that the subsequent interest has to be registered in order to claim priority. Had there been such a requirement, Chiips would not have had to rely on the subordination agreements as it would have had "super priority" as a PMSI-holder under s. 34 of the P.P.S.A. Accordingly, enforcement of a subordination agreement does not require that the subsequent creditor register his interest.

D. *Does enforcement of a subordination clause require that the claimant be a party to the original agreement?*

At common law (see *Greenwood Shopping Plaza Ltd. v. Beattie* (1980), 111 D.L.R. (3d) 257, [1980] 2 S.C.R. 228, 10 B.L.R. 234), Chiips, because it was is not a party to the debenture agreement might not be able to enforce the clause. I say "might" because the position at common law is not clear. Section 40 of the P.P.S.A. removes any doubt regarding the common law with respect to privity:

> 40. A secured party may, in a security agreement or otherwise, subordinate his security interest to any other interest, and the 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 a class of persons for whose benefit the subordination was intended.*

(Emphasis added.)

The cases considering s. 40 have similarly come to the conclusion that the section allows third parties to enforce subordination agreements: see *Euroclean*, and *Royal Bank v. Gabriel.* The

effect of the enactment of s. 40 is clearly explained by Houlden J.A. in *Euroclean* at pp. 301-2:

> In my opinion, s. 39 is intended to confer a statutory right on a secured party to waive the priority given him by the P.P.S.A. and to confer a corresponding right on the beneficiary of such a waiver to enforce it, *even though he is not a party to the agreement which created it or has no knowledge of its existence.*

(Emphasis added.)

This reasoning was adopted and applied by Philp J. in *Royal Bank v. Gabriel* at p. 309. There is no other reasonable interpretation of s. 40 but that in order to enforce a subordination agreement, the subsequent creditor need not be a party to the contract.

This court's finding that there is no registration requirement or privity requirement for PMSI-holders to enforce subordination clauses is completely in line with the rules of statutory interpretation. The principle is stated clearly in *Subilomar Properties (Dundas) Ltd. v. Cloverdale Shopping Center Ltd.* (1973), 35 D.L.R. (3d) 1 at p. 5, [1973] S.C.R. 596: "It is of course trite law that no legislation whether it be by statute or by-law should be interpreted to leave parts thereof mere surplusage or meaningless."

To hold that either registration or privity is required would have the effect of rendering s. 40 meaningless. If registration is required, there is no need for s. 40 whether the PMSI-holder is a party to the agreement or not because "super priority" would already have been achieved via s. 34. If privity is required, there is no need for s. 40; as stated by Houlden J. in *Euroclean* at p. 301, it would be "bootless" as it would have the effect of adding nothing to the common law.

E. *Conclusion*

For the above reasons, the appeal by Chiips should be allowed. As PMSI-holders Chiips is entitled to enforce the subordination clause and claim priority over the furnishings supplied. The funds which have been set aside pursuant to the order of Moshansky J., should be released to the appellant.

Appeal allowed.

issue in the latter's factum filed 21 March 1995. There is force in this submission. Unlike the Attorney General whose support on the mootness argument did not crystallize until the 1993 harvest was known, the effect of the 1992 legislation has been reasonably apparent to MacMillan Bloedel for some time.

49 I would direct each party should bear its own costs in this Court.

50 In his factum the Attorney General sought costs if the appeal had been dismissed on its merits. Ms. Westmacott did not seek costs when the appeal was dismissed as moot and took no part in the appeal from Mr. Justice Smith's order of 4 July 1994. I think in these circumstances the Attorney General should bear his own costs in this Court.

Appeal dismissed.

[Indexed as: **Discovery Enterprises Inc. v. Hongkong Bank of Canada**]

DISCOVERY ENTERPRISES INC. v. HONGKONG BANK OF CANADA BANK OF BRITISH COLUMBIA DIVISION;

Re Bankruptcy of RANGER MACHINERY INC.;

PEAT MARWICK LIMITED v. DISCOVERY ENTERPRISES INC. and HONGKONG BANK OF CANADA BANK OF BRITISH COLUMBIA DIVISION

Court of Appeal
Lambert, Gibbs and Hollinrake JJ.A.

Heard – March 20, 1995.
Judgment – June 22, 1995.

Banking – Loans and security – Section 427 security – Validity – Borrower's giving of s. 178 [now s. 427] security prior to registration of notice of intention rendering security void as against creditors – Bank's subsequent realization on its security improper and void as against other charge holders.

The plaintiff made a loan to the bankrupt secured by a floating charge debenture. The debenture anticipated the bankrupt subsequently granting security under s. 178 [now s. 427] of the *Bank Act*. The defendant bank then made loans to the bankrupt secured by s. 178 security. Although the notice of intention to give security under s. 178 was executed by the bankrupt before the grant of security was made, the defendant did not register it until later. The defendant appointed an agent to take possession of the bankrupt's assets. Following that appointment, the plaintiff made a formal demand under its debenture. The defendant's agent was appointed trustee in

bankruptcy. The plaintiff again made formal demand under its debenture. The trustee sold the bankrupt's primary assets and paid the net proceeds to the defendant. The plaintiff sued for a declaration that the defendant's s. 178 security was void as against the plaintiff by virtue of s. 178(4)(*a*). The plaintiff claimed in the alternative for a declaration that the s. 178 security ranked subsequent in priority to its debenture and it sought an accounting of funds received by the defendant. The action was dismissed and the plaintiff appealed.

Held – Appeal allowed.

When s. 178 security is properly given, legal title to the secured property passes to the bank. Possession remains in the grantee of the security who can deal with the secured property in the ordinary course of business, giving good title to property that is sold and bringing under the security property which is purchased. The grantor retains an equity of redemption to reacquire the legal title to the secured property on discharge of the debt. If the loan is not paid, the bank may seize and sell the property.

The phrase "void as against creditors" in s. 178(4)(*a*) of the *Bank Act* does not mean entirely void. The security will only be void as against creditors, while contractual rights between the bank and its customer will remain. Any claim to title is clogged by the claims of secured and unsecured creditors and must be subordinate to them. Here, the events had to be looked at on the basis that as against the plaintiff and all other creditors, the defendant's s. 178 security was void ab initio. That meant that the defendant's rights in rem were void and the only rights conferred by the imperfectly registered security were rights in personam. Those rights could not include title to the secured property. The bankrupt could not challenge the defendant's title, but no title could be asserted against creditors. Accordingly, the grant of the s. 178 security did not pass title to the defendant as against the plaintiff. Title remained, in effect, with the bankrupt. When the defendant's agent took possession of the property, it did so without any right to do so and the realization of the improperly registered security could not deprive the plaintiff of the security of its debenture.

Cases considered

Bank of Montreal v. Hall, [1990] 1 S.C.R. 121, [1990] 2 W.W.R. 193, 9 P.P.S.A.C. 177, 104 N.R. 110, 65 D.L.R. (4th) 361, 46 B.L.R. 161, 82 Sask. R. 120 – considered.

Canadian Imperial Bank of Commerce v. 281787 Alberta Ltd. (Crockett's Western Wear), [1984] 5 W.W.R. 283, 32 Alta. L.R. (2d) 183, 52 C.B.R. (N.S.) 13, (sub nom. *Canadian Imperial Bank of Commerce v. 281787 Alberta Ltd.*) 54 A.R. 238 (C.A.) – considered.

Clarkson v. McMaster & Co. (1895), 25 S.C.R. 96 – referred to.

Clarkson Co. v. Overland Finance Co., [1963] 1 O.R. 431, 4 C.B.R. (N.S.) 186, 37 D.L.R. (2d) 469 (C.A.) – considered.

Davanti Contemporary Interiors Ltd., Re, [1992] 6 W.W.R. 636, 4 Alta. L.R. (3d) 362, 133 A.R. 95 (Q.B.) – not followed.

Meriden Brittania Co. v. Braden (1894), 21 O.A.R. 352 (C.A.) – referred to.

Royal Bank v. First Pioneer Investments Ltd., [1984] 2 S.C.R. 125, 52 C.B.R. (N.S.) 225, 54 N.R. 255, 5 O.A.C. 195, 12 D.L.R. (4th) 1 – applied.

Statutes considered

Bank Act, R.S.C. 1985, c. B-1 [now S.C. 1991, s. 46]
s. 178 [now s. 427] – considered.
s. 178(3) [now s. 427(3)] – referred to.
s. 178(4)(*a*) [now s. 427(4)(*a*)] – considered.
s. 179(7) [now s. 428(7)] – referred to.
Corporation Securities Registration Act, R.S.O. 1970, c. 88 – referred to.

APPEAL from judgment of Edwards J., [1995] B.C.W.L.D. 1263, dismissing action for declaration that plaintiff's debenture ranking in priority to defendant's s. 178 security.

R.D. Holmes and *P. Roberts*, for appellant Discovery Enterprises Inc.

M. Clemens, Q.C., and *H. Ferris*, for respondent Hongkong Bank of Canada.

No one for Peat Marwick Limited.

(Docs. Vancouver CA018982, CA018981)

June 22, 1995. The judgment of the court was delivered by

LAMBERT J.A.:–

I

1 The principal issue in these appeals relates to whether security given by the Ranger Group to its bank under s. 178 of the *Bank Act*, before a Notice of Intention to grant the security was registered under the Act, takes priority, in the circumstances of this case, over prior security in the form of a floating charge debenture granted by the Ranger Group to Discovery, which was later crystallized. There are a number of questions of law and mixed law and fact which must be considered in relation to that issue.

II

2 The Ranger Group consists of three companies incorporated *early in 1985* to design, manufacture and market mechanized logging equipment.

3 In *April 1985* Discovery Foundation, a society established to provide funds to British Columbia enterprises, advanced $400,000 to the Ranger Group. The Ranger Group granted a floating charge debenture dated *25 April, 1985* to Discovery Foundation as security for the amounts advanced. On *31 January, 1986* Discovery Foundation gave a guarantee to the Bank of British Columbia in the amount of $50,000. Discovery Foundation later paid the amount of the guarantee to the Bank and the amount so paid also became secured by the debenture. The principal

amount owed under the debenture is therefore $450,000. The debenture interest rate is 11% and runs from the dates of the advances. The floating charge debenture provided that the charge did not prevent the Ranger Group from borrowing from banks and giving security permitted by the *Bank Act*, including security on book debts.

4 The Bank of British Columbia was asked to establish a line of credit for the Ranger Group and sometime in *late July or early August, 1985* it agreed to do so. As security the Bank took a General Assignment of Book Accounts and arranged for and received security documents under s. 178 of the *Bank Act* in the form of a Notice of Intention to Give Security dated *2 August, 1985*, an Application for Credit and Promise to Give Security dated *6 August, 1985*, a Grant of Security over: "All machinery equipment spares hardware tools and all goods wares and merchandise manufactured or purchased by the undersigned or procured for such manufacture and any of the same that may be in the process of manufacture" dated *6 August, 1985*, and a Standard Form of Contract Document which seems to have been dated *2 August, 1985*. On *14 August, 1985* the Notice of Intention was registered with the Bank of Canada.

5 Sometime after the s. 178 Application and Promise and the s. 178 Grant were delivered to the bank by Ranger on *7 August, 1985*, those two documents were altered with a pen very similar to the pen used by Mr. Holland who had executed the documents on behalf of the Ranger Group on 6 August. The alteration was designed to make it appear that those documents were dated 16 August rather than 6 August. A similar alteration was made to the Form of Contract Document. There was an agreed Statement of Facts which recorded the agreement of the parties that Mr. Holland did not make the alteration to the Form of Contract Document. Whether he made the alteration to the Application and Promise and to the Grant was in dispute as an issue of fact at trial.

6 In the period from *August, 1985* to *February 1986* the Bank made advances to the Ranger Group totalling $1,600,000.

7 There is a document in the Appeal Book which purports to record that a resolution was passed by the Ranger Group "as of the *21st day of January, 1986*" in these terms:

> WHEREAS:
>
> A. The Company has applied to Bank of British Columbia (the "Bank") for loans and advances for the purposes of its business;
>
> B. The Bank has made loans and advances to the Company on the security, inter alia, of the following security documentation executed by the Company in favour of the Bank;

(i) General Assignment of Book Accounts dated August 6, 1985;

(ii) Security under Section 178 of the *Bank Act* (Canada) dated August 16, 1985 (herein collectively called the "Bank's security").

C. The Company did not provide the Bank with a resolution of the Directors of the Company authorizing the execution and delivery of the Bank's security and the Bank has requested that the Directors of the Company ratify and confirm the execution and delivery by the Company of the Bank's security;

NOW THEREFORE BE IT RESOLVED THAT:

1. The execution and delivery of the Bank's security by Lawrence A. Holland for and on behalf of the Company be and the same is hereby approved and that the Bank's security be and the same is hereby ratified and confirmed.

2. Any Officer or Director of the Company is hereby authorized to execute under the common seal of the Company or otherwise and deliver to the Bank all such further documents, instruments and certificates as may be requested by the Bank in connection with loans to the Company.

8 By *February, 1986* the Ranger Group was in financial difficulty. The companies were unable to find customers for their product. On *19 February, 1986* the Bank's solicitors wrote to Peat Marwick Limited with respect to the Bank's security, in these terms:

Dear Sirs:

Re: Ranger Machinery Inc. (the "Company")

Please be advised that we act on behalf of the Bank of British Columbia (the "Bank") with respect to its loans to the above Company, which loans are secured, inter alia, by way of an Assignment pursuant to Section 178 of the Bank Act, (the "Assignment") from the above noted Company dated August 16, 1985 of all machinery equipment spares hardware tools and all goods wares and merchandise manufactured or purchased by the undersigned or procured for such manufacture and any of the same that may be in process of manufacture and that is now or may hereafter be in the place or places hereinafter designated, to wit in, at upon or near lands and premises or any of them situated firstly in the municipality of Delta, in the Province of British Columbia, and known as street No. 7983A Progress Way and any other place or places in Canada where the said security may be located, and everything on which security is capable of being given by the Company in accordance with paragraph 178(1)(j) of the *Bank Act* Canada. For your reference, we are enclosing herewith a photocopy of the Assignment.

The Company's business is that of a manufacturer, supplier and distributor of forestry equipment including harvesting machines which cut, buck and process timber into predetermined log sizes and machines which load the logs onto trucks and other modes of transportation in British Columbia. The Company has lost the support of a major supplier of

equipment and the business itself has not been achieving the expected or satisfactory level of performance. *In view of the financial problems which are currently facing the Company, several matters must be monitored and reported on and the Bank, with the concurrence of the principals of the Company and its guarantors, would ask that you notify the Bank if at any time during the course of this Agency Appointment, you determine the loans to the Company are in jeopardy and the underlying security of the Bank should be crystallized.*

Agency Appointment:

The Bank has instructed us and we do hereby designate and appoint Peat Marwick Limited its Agent under the provisions of the Assignment for the purposes of monitoring and controlling the operations of the Company and reporting back to the bank in that regard and more specifically to:

1. Analyze and evaluate the ongoing operations and contracts of the Company and determine the profitability thereof, provide an assessment of the present inventory and complete a projection with respect to inventory levels for the Company as ongoing business;

2. In conjunction with the principals of the Company, develop a plan satisfactory to the Bank and the Company as to the disposition or utilization of the eighteen units of machinery owed by the Company described in the Schedule to this Appointment. Subject only to the provisions of paragraph 6 of this Appointment, this plan is to be approved by the bank and the Company no later than the close of business on Friday, February 28, 1986;

3. At the earliest date, in conjunction with the principals of the Company, develop a plan to repay all loans owed by the Company to the Bank on or before March 31, 1986;

4. Although you are not asked to collect accounts receivable of the Company, we would ask you to prepare a report with respect thereto at your earliest convenience.

5. *Keep in daily contact with the bank with respect to the ongoing operations of the Company and obtain further instructions as may be required;*

6. *Advise the Bank immediately if at any time during the course of this Agency Appointment you determine that the Bank's loans to the Company or the security therefore will be jeopardized by continuing the Agency Appointment or the operation of the business and make recommendations as to any appropriate alternative steps which might be taken by the bank to protect its position.*

It should be understood that you are to maintain a very low profile in conducting this Agency Appointment and to the extent possible, you are not to be visible to either the employees of the Company, third parties having dealings with the Company, or the public generally.

You are appointed as Agent of the bank hereunder and all costs incurred by you in carrying out your duties hereunder are to be to the account of the Bank.

> *In the event*, in conjunction with the principals, you are unable to work out a plan as to the disposition and/or utilization of the eighteen units of machinery referred to in paragraph 1 hereof or develop a plan to repay the Bank loans on or before March 31, 1986 in accordance with paragraph 2 hereof, *or at any time you determine that the Bank's loans to the Company or the security therefor are in jeopardy, the bank in its discretion may instruct you to act on its behalf in recovering the loans outstanding to the Company.*
>
> Kindly acknowledge receipt of this Appointment at your earliest convenience by executing and returning the duplicate copy of this letter as provided. (my emphasis)

That appointment was acknowledged and consented to by the Ranger Group and accepted by Peat Marwick Limited on *19 February, 1986.* On the same date the Bank made a somewhat similar appointment of Peat Marwick Limited in relation to monitoring the accounts receivable of the Ranger Group.

9 On *25 February, 1986*, Discovery Foundation wrote to the Ranger Group in these terms:

> *We are advised that the Bank of British Columbia has appointed an agent in respect of Section 178 Bank Security* held by it in connection with certain assets of Ranger Machinery Inc. *Such appointment, together with the current financial situation of the Companies, constitutes events of default under* inter alia, *clauses 6(d) and 6(p) of the Debenture and,* in accordance with the terms of the Debenture, *all monies due thereunder are now due and payable by yourselves to Discovery Foundation.*
>
> *Accordingly, we hereby make formal demand for payment of monies due, owing, and payable to us, in the amount of $435,260.27 as of February 28, 1986 plus interest thereafter at the per diem rate of $131.17.*
>
> *If payment of the aforesaid sum is not made to our offices on or before February 28, 1986, by cash or certified cheque, we may enforce our rights provided in the Debenture, and any and all security rights held by us without further notice to you.* Notwithstanding the foregoing, if at any time prior to the said date, in our opinion any further material change has occurred in the affairs of the Companies, or any of them, we may forthwith enforce our rights provided in the Debenture and any and all security rights held by us without further notice to you. (my emphasis)

10 On *2 October, 1986* the Ranger Group made a voluntary assignment in bankruptcy. The official receiver appointed Peat Marwick Limited as Trustee.

11 On *2 February, 1987* Peat Marwick Limited, acting as trustee in bankruptcy of the estate of the Ranger Group, sold the Ranger Group inventory to a third party. The sale was done by the Trustee in Bankruptcy apparently in the belief that better assurances of title could be

given in that capacity. The amount realized on the sale of inventory was approximately $1,300,000. The fees of Peat Marwick Limited as agent of the Bank and as trustee in bankruptcy were $627,951. The net amount realized of approximately $725,000 was paid to the Bank of British Columbia in 1988. That amount was applied by the Bank against the indebtedness of the Ranger Group to the Bank. Nothing was paid to the Discovery Foundation.

12 Discovery Enterprises Ltd. is the successor to the Discovery Foundation. The Hongkong Bank of Canada, Bank of British Columbia Division, is successor to the Bank of British Columbia.

III

13 There are two separate proceedings. The first proceeding was an application for directions brought by Peat Marwick Limited with respect to the validity and enforceability of the Bank's security under s. 178 of the *Bank Act*. That application was brought in the bankruptcy proceedings. The second proceeding was an action by Discovery Enterprises Inc. against Hongkong Bank of Canada for a declaration that the s. 178 security held by the Bank was void against Discovery, for an accounting, and for judgment for the amount found due to Discovery on the accounting.

14 Both proceedings were tried together in the Supreme Court of British Columbia.

15 The trial judge decided [[1995] B.C.W.L.D. 1263], first, that the Bank had not discharged the onus of showing that the Ranger Group made a grant of security under s. 178 of the *Bank Act* on 16 August, 1985, rather than on 6 August, 1985. In short, the alteration of the security documents was not made by someone authorized by the Ranger Group to grant the security or to make the alteration.

16 The trial judge decided, second, that the resolution purporting to have been passed "as of 21 January, 1986" did not constitute an acknowledgment by Ranger that the grant of security was as effective as if it had been given on 16 August, 1985.

17 However, the third decision of the trial judge was that although the s. 178 security in favour of the Bank was void against creditors of the Ranger Group under s. 178(4)(*a*) of the *Bank Act*, it was not void between the Ranger Group and the Bank: That as between the Ranger Group and the Bank the security documents passed title in the goods covered by the security to the Bank: That when the Bank appointed Peat Marwick

Limited as its agent in relation to the s. 178 security and when, what the trial judge described as "the seizure of Ranger's assets", occurred immediately thereafter, the Bank's dealings with the security were complete and it had both title to the security assets and possession of those assets before the floating charge under the Discovery debenture crystallized, which occurred, at the earliest, on 25 February, 1986 when Discovery's default and demand letter was written: And that when Discovery's floating charge crystallized the assets covered by the s. 178 security were no longer owned or possessed by the Ranger Group and accordingly the floating charge did not crystallize on them and they were never subject to the fixed charge in favour of Discovery resulting from that crystallization. The trial judge relied on the decision of Mr. Justice Virtue of the Alberta Court of Queen's Bench in *Re Davanti Contemporary Interiors Ltd.*, [1992] 6 W.W.R. 636, and the trial judge cited and followed this passage at p. 646:

> At the date of bankruptcy the inventory which the bank owned by way of its security and which it had taken into its possession pursuant to its power of seizure and sale under the *Bank Act*, was no longer property of the bankrupt within the meaning of s. 67 of the *Bankruptcy Act*. The bank is not seeking to enforce its security interest against the creditors of Davanti or the trustee. It could not do that because its security is void against them. It is simply resisting an application by the trustee to get back property which prior to the bankruptcy was owned by and in the legal possession of the bank.
>
> In my view, therefore, the imperfection of the bank's registration of its security is not the whole answer. Although the protective netting of registration was flawed, the fruit had been harvested before the birds descended upon the vine.

18 As a fourth point, though I do not understand that it affected his decision, the trial judge decided that in fact the crystallization was not treated by Discovery as having occurred until the voluntary assignment in bankruptcy of the Ranger Group on 30 October, 1986 and so should not be considered to have occurred before that date.

19 The trial judge summarized his decision in this way in these two paragraphs at the conclusion of his reasons [pp. 20-21]:

> In bankruptcy proceeding 1613/86 I direct that the bank's s. 178 security was valid between the bank and Ranger and the bank acted within the terms of its security in taking possession of the assets of Ranger on February 19, 1986. Since that seizure antedated the crystallization of Discovery's floating charge, that floating charge does not have the effect of displacing the bank's s. 178 security, notwithstanding that the bank's s. 178 security would be unenforceable against Discovery by virtue of the fact it was granted prior to the registration of a notice of intention had

Discovery acted on its floating charge security prior to the bank taking possession of Ranger's assets.

In Action No. C902797, I decline to make a declaration that s. 178 security is void as against the plaintiff. It would have been unenforceable if Discovery's floating charge had crystallized prior to the bank exercising its s. 178 security. I dismiss Discovery's claim for a declaration that the s. 178 security ranks in priority subsequent to the security constituted by the Debenture and the claim for an accounting.

IV

20 Subsection 178(4)(*a*) of the *Bank Act* reads in this way:

(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 of 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.* (my emphasis)

21 In this case no notice of intention was registered before the security was given. Accordingly, the section provides that 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. With respect, it seems to be a strange result of the trial decision that the bank can act on a security that is void against creditors to seize property covered by the security, realize the security, and keep the proceeds, without any regard for either the secured creditors or the unsecured creditors of the company which gave the unregistered security to the bank. Surely it is not an answer that the bank acted on the security that is void against creditors before the creditors realized what was happening and by making a pre-emptive strike was able to achieve the same result on a security that was void against creditors as it would have been able to achieve on a security that was valid for all purposes, namely, the exclusion of other creditors, secured or unsecured, from the proceeds of its realization.

22 The analytical starting point must rest on the nature of s. 178 security. The decision of the Supreme Court of Canada in *Bank of Montreal v. Hall*, [1990] 1 S.C.R. 121 [[1990] 2 W.W.R. 193], confirmed the law as it had been generally understood before that decision. When s. 178 security is properly given, legal title to the secured property passes to the bank. Possession remains in the grantee of the security who can deal with the secured property in the ordinary course of business, giving good

title to property that is sold and bringing under the security property which is purchased. The grantor retains an equity of redemption to reacquire the legal title to the secured property on discharge of the debt. If a loan for which the security was given is not paid, the bank may take possession of, or seize, the property covered by the security under s. 178(3) and may sell that property and apply the proceeds against the loan under s. 179(7).

23 The next step is to consider what is meant by the phrase "void as against creditors", in s. 178(4)(*a*). It clearly does not mean entirely void. The bank will have advanced funds to the security grantor. The debt arising from those advances will remain a valid debt independent of the validity of the security for the debt, but, in addition, as between the bank and the security grantor, there is nothing in this section which makes the security void. The section does not provide that the security is void for all purposes, only that it is void against creditors. So, as between the bank and its customer, the Grant of security to the bank creates contractual rights. But any claim to title is clogged by the claims of secured and unsecured creditors and must be subordinate to them.

24 It was argued on this appeal on behalf of the Bank that the words "void as against creditors" do not mean that, but rather mean "voidable as against creditors". The security, it was argued, does not become void until the creditor takes a step to make the security become void. Whether that step makes it void against all creditors or only against the creditor who took the step was not made clear in the argument. I would not accede to that argument. It is contrary to the plain meaning of the words chosen by Parliament to express its intention. That plain meaning was preferred by the Alberta Court of Appeal in *Canadian Imperial Bank of Commerce v. 281787 Alberta Ltd. (Crockett's Western Wear)*, [1984] 5 W.W.R. 283, a unanimous decision of the Alberta Court of Appeal, where Mr. Justice Stevenson gave the judgment of a division of the Court consisting of Mr. Justice Moir, Mr. Justice Belzil and himself. The argument is also contrary to the concept of a practical system for allocating the proceeds of realization of the security among creditors, particularly if each creditor must take a step in order to make the security void against that particular creditor. Finally, and most importantly, the argument is contrary to the decision of the Supreme Court of Canada in *Royal Bank v. First Pioneer Investments Ltd.*, [1984] 2 S.C.R. 125, where a similar question was considered in relation to whether an unregistered debenture was void or merely voidable under s. 2 of the *Corporation Securities Registration Act* of Ontario which provided that unregistered charges

were "void as against creditors of the mortgagor". The Supreme Court of Canada decided in a unanimous judgment of five judges, in reasons given by Madam Justice Wilson, that "void" meant void ab initio and not voidable. There is no basis on which a different conclusion could rest in relation to security under s. 178 of the *Bank Act*.

25 So we must look at the events in this case on the basis that as against Discovery and all other creditors of the Ranger Group the Bank's s. 178 security was void ab initio. That must mean that all the Bank's rights in rem are void and the only rights that are conferred by the imperfectly registered security are rights in personam. Those rights cannot include title to the secured property. Ranger cannot challenge the Bank's title, but no title can be asserted by the Bank against creditors.

26 In the result, the Grant of the s. 178 security did not pass title to the Bank with respect to the secured property, as against Discovery. The title, in effect, remained in the Ranger Group. When the Bank appointed Peat Marwick Limited as its agent then, if Peat Marwick took possession of the secured property, it did so improperly and without any right to do so, because the Bank had no right itself to do so. Similarly, all the later acts undertaken by Peat Marwick Limited, including the sale of the property, and including the payment of the proceeds of sale to the Bank, were improper and were done without any right to do so.

27 As I mentioned, the trial judge relied on *Re Davanti*, a decision of Mr. Justice Virtue in the Alberta Court of Queen's Bench. On facts very similar to the facts of this case, Mr. Justice Virtue explicitly decided that "void against creditors" under s. 178(4)(*a*) of the *Bank Act* meant voidable against creditors. In reaching that conclusion Mr. Justice Virtue relied on *Meriden Brittania Co. v. Braden* (1894), 21 O.A.R. 352 (C.A.), and *Clarkson v. McMaster & Co.* (1895), 25 S.C.R. 96. He relied also on *Clarkson Co. v. Overland Finance Co.* (1963), (sub nom. *Re Shelly Films Ltd.*) 37 D.L.R. (2d) 469 (Ont. C.A.). *Re Shelly Films Ltd.* was expressly overruled by the Supreme Court of Canada in *Royal Bank v. First Pioneer Investments Ltd.*, at p. 133. The two other decisions relied on by Mr. Justice Virtue can no longer be regarded as expressing any general proposition of law that "void against creditors" in a registration statute means "voidable against creditors". Mr. Justice Virtue did not refer to the decision of the Supreme Court of Canada in *Royal Bank v. First Pioneer Investments Ltd.* Neither did the trial judge in this case. In my opinion they were both led into error by not being asked to consider that case.

28 In my opinion, the realization of the Bank's improperly registered security under s. 178 of the *Bank Act*, which was void against creditors, could not deprive Discovery of the security of its floating charge debenture which later crystallized either on 25 February, 1986, when demand was made following events of default, or on 30 October, 1986, when the Ranger Group made assignments in bankruptcy. The security property had not yet been sold on the latter date. The property in question was therefore subject to Discovery's fixed charge created by the crystallization of its floating charge when that property was dealt with by Peat Marwick Limited and disposed of by that company either as agent of the Bank or as trustee in bankruptcy.

29 For those reasons I would allow the appeals. However, there were four other arguments advanced for allowing the appeals and I propose to mention them briefly in Pt. V of these reasons. And there were five further arguments advanced for dismissing the appeals and I will deal with those five arguments briefly in Pt. VI of these reasons.

V

30 On behalf of Discovery, four alternative arguments were advanced in support of its claim as a secured creditor under its crystallized floating charge debenture in priority to the Bank's claim under its s. 178 security which was void against Discovery. I do not propose to rely on any of those four arguments but I do not reject them. It is simply not necessary to deal with them.

31 The first argument was that the appointment of Peat Marwick Limited as agent of the Bank was expressly for the "purpose of monitoring and controlling the operations of the company and reporting back to the bank in that regard." That appointment did not authorize Peat Marwick Limited to take possession of the secured property or to seize it as contemplated by s. 178(3) of the *Bank Act*. Thus Peat Marwick Limited was never authorized to take possession of the secured property or to seize it and never lawfully did so as agent of the Bank. Its authority was to notify the Bank if it thought that the Bank's underlying security should be crystallized.

32 The second argument was consistent with the first. It was that when Peat Marwick Limited sold the secured property it did so expressly as trustee in bankruptcy of the Ranger Group. It could only have acquired title in that capacity if it had never taken possession of the property or seized the property as agent of the Bank, or unless, having done so, it surrendered the property to the trustee in bankruptcy and, on behalf of the

Bank, waived the security and elected on behalf of the Bank that the Bank be treated as an ordinary creditor. Of course, either of those courses would have involved a disregard of Discovery's debenture security.

33 The third argument was that the alteration of the security documents given under s. 178 of the *Bank Act*, while those documents were in possession of the Bank, means that the security created by those documents is entirely void for all purposes, not merely void as against creditors of the Ranger Group.

34 The fourth argument was that Discovery's floating charge crystallized when notice of default was given and a demand was made under Discovery's debenture on 25 February, 1986; and that a subsequent hiatus in the enforcement of the Discovery debenture when Peat Marwick Limited was in attendance at the Ranger operations cannot operate to free the fixed charge from its hold on the assets on which it crystallized and cannot cause it to revert to its former floating status. That result could only be achieved by a release of the fixed charge and the creation of a new floating charge. Accordingly, any action of Peat Marwick Limited which could be regarded as asserting possession of the secured assets on behalf of the Bank after 25 February, 1986 and before 30 October, 1986, the date of bankruptcy, cannot affect Discovery's crystallized and therefore fixed charge under its debenture security.

35 I do not propose to say anything further about those four arguments.

VI

36 There were five additional arguments advanced on behalf of the Bank.

37 The first was that if the Bank changed the date on the security, it did so under the authority of the s. 178 Application for Credit and Promise to Give Security which contains this clause:

> The undersigned hereby appoints the person for the time being acting as manager of the above-mentioned branch of the Bank, the attorney of the undersigned, on behalf of the undersigned, to give from time to time to the Bank any and all security mentioned above or to sign or endorse and deliver any and all instruments and documents in connection therewith.

It would be a strange provision which permitted the Bank to grant security documents to itself. It would be an equally strange provision which permitted the Bank to alter security documents given to it without express consent by the grantor to the specific alteration, but merely under

the general terms of the s. 178 Application for Credit and Promise. The authority is surely an authority to give documents of title, such as warehouse receipts or bills of lading, required to deal with the assets charged, not to give the very security itself nor to alter the very security itself. This argument is also entirely inconsistent with the position that the Bank has taken that it has not been established that the Bank altered the documents while in its possession, though the Bank no longer disputes the finding of fact by the trial judge that it had not discharged the onus of showing that an authorized officer of the Ranger Group made the alteration.

38 The second argument was that no one was prejudiced by the fact that the Notice of Intention was filed six days after the grant of the security. I do not understand that there is any question under the *Bank Act* about whether a failure to observe the provisions of the Act only operates to the detriment of the Bank if someone is prejudiced by the failure. Nor do I understand that a failure to register the Notice of Intention before the granting of the security only delays the effective date of the security until the Notice of Intention is registered. In the absence of statutory provisions to that effect the question of prejudice is irrelevant.

39 The third argument was that this was not a case of non-registration but rather a case of imperfect registration. This argument seems to me to be related to the second argument and fails for the same reason. If the argument suggests that the effect of non-registration is that the security is void against creditors but the effect of imperfect registration is that the security is merely voidable against creditors then there is no support for that argument in the statute. In addition, it seems that such an argument contemplates that late registration would result in the security being void until registration occurred and then becoming voidable when registration was made. I do not regard such a result as conceptually possible.

40 The fourth argument was that the resolution that was recorded in a document as having been passed "as of the 21st day of January, 1986" had the effect of treating the giving of security as if it had been granted on 16 August, 1985 and had the effect of ratifying the grant as of that date, with the suggested result that the void security became valid. I do not believe that such a feat is possible, but if it were, I agree with the trial judge's conclusion that the wording of the resolution is not in sufficiently apt language to accomplish it.

41 The fifth argument was that Discovery is estopped by its conduct in agreeing with the Bank that the Ranger Group's indebtedness to Dis-

covery would be subordinated to the Bank's security under s. 178, and by incorporating a clause to that effect in its debenture security in general terms, from attacking the validity of the bank's security. I do not think that the effect of those acts on the part of Discovery is to prevent it from saying that the Bank's security is void against Discovery if that is so. But Discovery never agreed that void security would rank ahead of its debenture. Its agreement was limited to valid security.

42 I would not accede to any of those five arguments made on behalf of the Bank.

VII

43 I would allow both appeals.

44 I would declare that Discovery's debenture security has priority over the Bank's security under s. 178 of the *Bank Act*. I would declare that the Bank's security under s. 178 of the *Bank Act* is void against Discovery.

45 There are other orders which may be required. It may be necessary to have an accounting of what was wrongfully paid to the Bank as the proceeds of realization of the Bank's security. It may be necessary to have an accounting of what is owed to Discovery under its debenture. It is possible that other creditors, secured or unsecured, may be involved. Perhaps further bankruptcy proceedings will be necessary. I would order that whatever proceedings are required, if any, which come within the scope of the two proceedings on which these appeals have been brought, should be referred back to the Supreme Court of British Columbia to be dealt with there in accordance with these reasons.

46 I would order the Hongkong Bank to pay party and party costs to Discovery with respect to these two appeals, but without duplication for matters such as counsel fees where the service was provided only once. Discovery should also have its party and party costs in the Supreme Court of British Columbia on Scale 3 against the Hongkong Bank with respect to action No. C902797 and, to the extent that additional taxable costs were incurred by Discovery in relation to action No. 1613/86, Discovery should have those party and party costs paid by Peat Marwick Limited, the trustee in bankruptcy, whose application started those proceedings.

Appeal allowed.

5 P.P.S.A.C. 269, 45 Sask. R. 291, 27 D.L.R. (4th) 718

1986 CarswellSask 101

Dubé v. Bank of Montreal

DUBE v. BANK OF MONTREAL et al.

Saskatchewan Court of Appeal

Hall, Vancise and Gerwing JJ.A.

Judgment: January 17, 1986

Docket: No. 8669

Counsel: G.A. Zabos, for respondent, Dube.

J.A. Davis, for the appellant, Bank of Montreal.

A.M. Mason, for Cadentia Investments.

Subject: Insolvency; Property; Corporate and Commercial

Personal Property Security --- Scope of legislation -- Liens and trusts.

Personal Property Security --- Attachment of security interest -- Special rules -- Purchase money security interests.

Personal Property Security --- Priority of security interest -- Security interests versus other interests -- Under provincial law -- Lien, charge or other interest given by statute or rule of law -- Distress for rent.

The judgment of the Court was delivered by Vancise J.A.:

1 The respondent, Leslie Dube, applied pursuant to s. 33 of the Personal Property Security Act, S.S. 1979-80, c. P-6.1

for an order to determine the priority of claims between a landlord claiming the right to distrain certain chattels and the appellant Bank of Montreal claiming an interest in the chattels under a purchase-money security interest. Walker J., found the right of the landlord to distrain had priority and the bank of Montreal appeals that decision.

Facts

2 On June 1, 1981, the landlord agreed in writing to an assignment of a lease to the respondents Merle Isaacson, Scott Thoen, Kim Gloeden and Robert Gloeden carrying on business under the firm name of "Cadentia Investments," certain real property located at 3310 Fairlight Drive, Saskatoon. The Bank of Montreal advanced Cadentia $77,000 for the purchase of a business from H.G. Enterprises Ltd., known as "Fairhaven Billiards" which was located at 3310 Fairlight Drive. By a secruity agreement in writing dated May 31, 1982, Cadentia mortgaged certain chattels to the Bank of Montreal for the sum of $60,000. The sum of $77,500 was advanced by Cadentia to the vendor, H.G. Enterprises Ltd., for the purchase of the business and certain chattels. The agreement evidencing such purchase did not provide for any allocation of the purchase price between the various assets. On September 2, 1983, the appellant registered a financing statement to protect its security in the property pursuant to the Personal Property Security Act. It did not claim a purchase- money security interest in the property at that time. On November 14, 1983, the bank filed an amended financing statement claiming a purchase-money security interest in the property which was listed on the schedule attached to the chattel mortgage.

3 In April of 1984, Cadentia defaulted on the rent, and at July 1, 1984, owed the respondent Dube $11,019.31 for rent. On June 19, 1984, the landlord distrained certain property located on the business premises. Subsequent to the distress, the landlord became aware of the registered security interests of the bank and that the bank claimed priority to the chattels distrained by the landlord.

Issues

4 There are two issues on this appeal. First, does the Landlord and Tenant Act, R.S.S. 1978, c. L-6, determine the priorities between the parties, or are they governed by the Personal Property Security Act. Secondly, is the interest of the bank in the chattels a purchase-money security interest.

1. Priorities

5 The appellant contends that the Personal Property Security Act governs the relationship between the parties and that under that Act it has a perfected purchase-money security interest which is enforceable against a third party, the landlord Dube. It submits that it has complied with ss. 10, 12, 19 and 25 of the Act. The respondent Dube contends that s. 4(a) of the Act specifically provides that it does not apply to the distraining of rent by a landlord. That section reads as follows:

> 4. Except as specifically otherwise provided, this Act does not apply to:
>
> (a) a lien, charge or other interest given by statute or a lien given by rule of law for the furnishing of goods, services or materials.

It is the position of the respondent Dube that the right to distrain is a common law right and as such exempt from the provisions of the Act. The question of whether the Act applied to a distress by a landlord was considered in *Commercial Credit Corp. v. Harry D. Shields Ltd.* (1980), 29 O.R. (2d) 106, 1 P.P.S.A.C. 99, 15 R.P.R. 13, 112 D.L.R. (3d) 153 (H.C.). Holland J. found that the right of distress was not a lien but that where a landlord took possession of chattels pursuant to a right of distress a lien arose by operation of law. That decision was affirmed on appeal at (1981), 32 O.R. (2d) 703, 1 P.P.S.A.C. 301, 14 B.L.R. 121 (*sub nom. Braukmann Holdings Ltd. v. Commercial Credit Corp.*), 122 D.L.R. (3d) 736. Weatherston J.A., speaking for the Court stated at p. 703 [O.R.]:

> Section 3(1)(a) of the *Personal Property Security Act* exempts from the application of that Act 'a lien given by statute or rule of law'. A distress is the right of a landlord to take and hold possession until rent is paid, plus the statutory

right to sell the distrained goods. We agree with the trial Judge that a distress, when made, confers on the landlord a lien within the meaning of s. 3(1)(a) of the *Personal Property Security Act* notwithstanding that it has other legal incidents.

There is, however, a difference in the wording of s. 3(1)(a) of the Personal Property Security Act of Ontario (R.S.O. 1980, c. 375) and s. 4(a) of the Saskatchewan Act [Personal Property Security Act, S.S. 1979-80, c. P-6.1]. The Ontario Act reads as follows:

3. -- (1) This Act does not apply,

(a) to a lien given by statute or rule of law, except as provided in s. 32, clause 36(3)(*b*) and clause 37(2)(*b*);

(b) to a transfer of an interest or claim in or under any policy of insurance or contract of annuity.

6 The Saskatchewan Act appears to limit a lien created by law to one for the furnishing of "goods, services and materials." The Ontario Act contains no such limitation but provides for an exception for a lien given by a rule of law. The Ontario Act does not provide a statutory right of distress and for the exception to apply it must come under the common law. The Saskatchewan Landlord and Tenant Act, R.S.S. 1978, c. L-6 does provide a statutory right of distress. Section 19 of that Act reads:

19. Every person may have the like remedy by distress, and by impounding and selling the property distrained, in cases of rent seck, as in case of rent reserved upon lease.

In my opinion, the statutory right of distress in the Landlord and Tenant Act is a "lien, charge or other interest given by statute" and the Personal Property Security Act does not apply to determine the priorities in these circumstances. The priorities must be determined by the provision of s. 25 [am. 1979-80, c. 28, ss. 3, 4; am. 1981-82, c. 16, s. 31(1)] of the Landlord and Tenant Act. That section reads as follows:

25(1) In this section:

(*a*) 'purchase-money security interest' means:

(i) a security interest that is taken or reserved by a seller, lessor or consignor of personal property to secure payment of all or part of the sale or lease price; or

(ii) a security interest that is taken by a person who gives value for the purpose of enabling the debtor to acquire rights in or to personal property, to the extent that the value is applied to acquire such rights;

(*b*) 'security agreement' means an agreement that creates or provides for a security interest;

(*c*) 'security interest' means an interest in goods that secures payment or performance of an obligation.

(1.1) No landlord shall distrain for rent on the goods and chattels of any person except the tenant or person who is liable for the rent, even though the goods or chattels are found on the premises.

(2) Subsection (1.1) does not apply:

(*a*) in favour of a person claiming title under an execution against the tenant;

(*b*) in favour of a person whose title is derived by purchase, gift, transfer or assignment from the tenant, whether absolute or in trust, or by way of a security agreement, other than a security agreement creating a purchase-money security interest, or otherwise;

(*c*) to the interest of the tenant in any goods or chattels on the premises in the possession of the tenant under a contract for purchase, or by which he may or is to become the owner thereof upon performance of any condition;

(*d*) where goods or chattels have been exchanged between tenants or persons by the one borrowing or hiring from the other for the purpose of defeating the claim of or the right of distress by the landlord; or

(*e*) where the property is claimed by the wife, husband, daughter, son, daughter-in-law, or son-in-law of the tenant or any other relative of his if the relative lives on the premises as a member of the tenant's family or by a person whose title is derived by purchase, gift, transfer or assignment from any of the said relatives.

(3) In this section 'tenant' means a person holding directly of the landlord.

If the Legislature had not intended the Landlord and Tenant Act to govern disputes between priorities between a landlord and persons claiming an interest in chattels, there would have been no need to amend the Landlord and Tenant Act to make reference to security agreements, or purchase-money security interest. Priorities would simply have been determined pursuant to the Personal Property Security Act. An examination of that Act, however, reveals that it would be impossible for a landlord to maintain a priority over a perfected security interest because those security interests are consensual in nature and the landlord could not perfect its security interest until the time of distress.

Priorities

7 Having decided that the right to distress is a statutory lien to which the Personal Property Security Act does not apply, one must examine s. 25 of the Landlord and Tenant Act to determine whether the landlord has priority in the circumstances. Section 25(1.1) and 2(*b*) combine to give a preferential position to a purchase-money security interest. A holder of a security agreement creating a purchase-money security interest is not liable to have the personal property which is the subject of the security agreements distrained for rent. The appellant contends that it has a purchase-money security interest and therefore has priority over the rights of the landlord.

8 For the appellant to have a purchase-money security interest, it must establish that it had a security interest, that is, an interest in goods that secures payment of an obligation, which was taken by it after giving value to enable the tenant to acquire rights to the goods and that such money was applied on the acquisition of such goods. The onus is on the appellant to establish that it has a purchase-money security interest at the time of distress and that the property was therefore excempt from seizure. (See *Yachuk v. Oliver Blais Co.*, [1944] O.W.N. 412 at p. 418, 3 D.L.R. 615 (H.C.), reversed [1945] O.R. 18, [1945] 1 D.L.R. 210 (C.A.), reversed [1946] S.C.R. 1, [1946] 1 D.L.R. 5 (S.C.C.), reversed on other grounds and Court of Appeal judgment restored [1949] A.C. 386, [1949] 2 W.W.R. 764, [1949] 2 All E.R. 150, [1949] 3 D.L.R. 1 (P.C.) and cited therein, *Montreal v. la Corporation du College Ste-Marie*, [1921] A.C. 288, [1920] 54 D.L.R. 520 (P.C.))

9 The chattel mortgage granted by the tenant to the appellant was a security interest as contemplated by s. 25(1)(*c*) of the Landlord and Tenant Act. It provided that in consideration of the sum of $60,000 lent to it, (the tenant) "grants, bargains, sells, and assigns to the [bank] the chattels set forth. ..." The chattels were listed in a schedule which was attached to the chattel mortgage. A purchase-money security agreement is distinctively different interest from a security interest. The interest must be one created by the advancing of money for the purpose of enabling the debtor to acquire rights to property and the money advanced must be applied toward the acquisition of those rights. There are two documents before the Court which deal with the security interest of the appellant, the chattel mortgage, and the sales

agreement between H. & G. Enterprises Ltd. and Cadentia. The sales agreement does not appropriate any portion of the purchase price to chattels or equipment. The chattel mortgage does not state that the money was advanced for the purpose of enabling the debtor to acquire the chattels, and it does not indicate that any portion of the $60,000 has been applied toward the acquisition of rights in property. The appellant sought to buttress that shortfall by filing an affidavit of one of its employees which stated that the $60,000 was loaned for the purpose of enabling Cadentia to purchase certain chattels listed in the schedule attached to the chattel mortgage. The respondent submits that that evidence should not be admitted as being inadmissible under the parole evidence rule. I agree with that submission. The evidence is inadmissible. The necessary ingredients to create a purchase-money security interest must be found in the documents themselves. There is no evidence that money was advanced for the purpose of enabling the appellant bank to acquire rights in personal property, or any evidence that the $60,000 was applied to acquire such rights. Even if I am wrong in concluding that the affidavit evidence should not be admitted, the appellant bank still has failed to satisfy the onus of establishing that the money so advanced was applied for the purpose of acquiring the property rights in the chattels.

10 The appellant bank has failed to establish that it has a purchase-money security interest and therefore the landlord has a prior claim to the chattels under its right of distress.

11 In the result the appeal is dismissed with costs.

Appeal dismissed.

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34 C.B.R. (4th) 169

2002 CarswellOnt 2003

Engel Canada Inc. v. TCE Capital Corp.

Engel Canada Inc., Applicant and TCE Capital Corporation and Perry Krieger & Associates Inc., Respondents

Ontario Superior Court of Justice [Commercial List]

Wilson J.

Heard: May 14, 2002

Judgment: June 14, 2002

Docket: 02-CL-4485

Counsel: David E. Mende, for Applicant

Michael R. Kestenberg, for Respondents

Subject: Corporate and Commercial; Insolvency

Personal property security --- Priority of security interest -- Subordination and postponement

R Inc. purchased machines from E Inc. for which C Ltd. provided financing -- T Corp. provided credit to R Inc. by way of revolving and instalment loans -- R Inc. granted T Corp. general security interest in all of R Inc.'s present and after acquired personal property further to general security agreement -- By terms of agreement, R Inc. granted T Corp. security interest in after acquired collateral -- Agreement excluded permitted encumbrances from warranty provisions, including purchase money liens or other encumbrances to secure unpaid purchase price in respect of property or asset -- E Inc. provided other machines to R Inc. -- As E Inc. anticipated financing by C Ltd., it did not register purchase money security interest within ten days of shipping machines -- E Inc. brought application for determination of priority with respect to machines for which C Ltd. provided no financing -- E Inc.'s purchase money lien had priority to interests of T Corp. -- E Inc. had purchase money lien regarding machines but did not have super priority -- Allowing purchase of specified encumbered asset without granting priority in encumbrance appeared to be hollow right that did not make commercial sense unless subordination was implicit.

Cases considered by Wilson J.:

Asklepeion Restaurants Ltd. v. 791259 Ontario Ltd., 11 P.P.S.A.C. (2d) 320, 6 O.T.C. 326, 1996 CarswellOnt 1533 (Ont. Gen. Div.) -- considered

Asklepeion Restaurants Ltd. v. 791259 Ontario Ltd., 1998 CarswellOnt 2303, 13 P.P.S.A.C. (2d) 295 (Ont. C.A.) -- referred to

Bank of Montreal v. Dynex Petroleum Ltd. (1995), 39 Alta. L.R. (3d) 66, [1996] 6 W.W.R. 461, 11 P.P.S.A.C. (2d) 291, 1995 CarswellAlta 710 (Alta. Q.B.) -- considered

Canadian Imperial Bank of Commerce v. Otto Timm Enterprises Ltd., 130 D.L.R. (4th) 91, 87 O.A.C. 148, 26 O.R. (3d) 724, 39 C.B.R. (3d) 139, 10 P.P.S.A.C. (2d) 228, 1995 CarswellOnt 1445 (Ont. C.A.) -- referred to

Chiips Inc. v. Skyview Hotels Ltd., 21 Alta. L.R. (3d) 225, [1994] 9 W.W.R. 727, 27 C.B.R. (3d) 161, 7 P.P.S.A.C. (2d) 23, (sub nom. Chiips Inc. v. Skyview Hotels Ltd. (Receivership)) 155 A.R. 281, (sub nom. Chiips Inc. v. Skyview Hotels Ltd. (Receivership)) 73 W.A.C. 281, 116 D.L.R. (4th) 385, 1994 CarswellAlta 350 (Alta. C.A.) -- considered

Euroclean Canada Inc. v. Forest Glade Investments Ltd., 49 O.R. (2d) 769, 16 D.L.R. (4th) 289, 8 O.A.C. 1, 54 C.B.R. (N.S.) 65, 4 P.P.S.A.C. 271, 1985 CarswellOnt 154 (Ont. C.A.) -- considered

Furmanek v. Community Futures Development Corp. of Howe Sound, 162 D.L.R. (4th) 501, 110 B.C.A.C. 212, 178 W.A.C. 212, 1998 CarswellBC 1614, 14 P.P.S.A.C. (2d) 1, 61 B.C.L.R. (3d) 254 (B.C. C.A.) -- referred to

Royal Bank v. Tenneco Canada Inc., 72 O.R. (2d) 60, 66 D.L.R. (4th) 328, 9 P.P.S.A.C. 254, 1990 CarswellOnt 607 (Ont. H.C.) -- referred to

Sperry Inc. v. Canadian Imperial Bank of Commerce, 50 O.R. (2d) 267, 17 D.L.R. (4th) 236, 8 O.A.C. 79, 55 C.B.R. (N.S.) 68, 4 P.P.S.A.C. 314, 1985 CarswellOnt 167 (Ont. C.A.) -- considered

Sun Life Assurance Co. of Canada v. Royal Bank, 129 D.L.R. (4th) 305, 37 C.B.R. (3d) 89, 10 P.P.S.A.C. (2d) 246, 1995 CarswellOnt 1168 (Ont. Gen. Div. [Commercial List]) -- considered

Statutes considered:

Personal Property Security Act, R.S.O. 1990, c. P.10

Generally -- referred to

s. 38 -- considered

APPLICATION by vendor for determination of priority with respect to machines sold to debtor.

Wilson J.:

1 Two creditors of a bankrupt seek priority with respect to certain equipment. Engel Canada Inc. (Engel) seeks a declaration that its security interest in three injection molding machines (the Machines) ranks in priority to TCE Capital Corporation's (TCE) security interest. It seeks an injunction against the disposition of the Machines by the private receiver manager of Renwel Inc. (Renwel) appointed by TCE.

The Participants

2 Engels manufactures and sells injection molding machines which process plastic products.

3 TCE is in the business of lending money.

4 Renwel Inc. is a private Ontario corporation which manufactures plastic products.

5 CIT Financial Ltd. (CIT) is in the business of equipment lease financing.

The Problem

6 When the Machines were shipped by Engel it was anticipated that financing would be provided by CIT. CIT had provided financing for other equipment sold by Engel to Renwel. CIT by registration, had PPSA priority to the general security agreement registered by TCE. CIT did not provide the anticipated financing prior to or after shipment of the Machines. Renwel signed security agreements in favour of Engel at the time that the Machines were shipped. However, anticipating financing by CIT, Engel did not protect the priority of its super security by registering a purchase money security interest (PMSI) within ten days of shipping the Machines. Therein lies the problem. The outstanding balance on the purchase price for the Machines owed to Engel is $1,444,370.00.

The Issues

7 Engel asserts that its security interest in the Machines has priority because:

(a) TCE's security interest did not attach to this equipment; or

(b) TCE subordinated its security interest in the machines in favour of Engel's security interest therein, by the terms of the governing documentation, or by conduct.

8 TCE submits that Engel's Application should be dismissed, because:

(a) Engel perfected its security interest in this equipment more than three (3) months after the debtor acquired an interest therein and therefore failed to satisfy the statutory requirements necessary to create a PMSI ranking in priority to TCE's prior perfected security interest; and

(b) TCE's security documents provide expressly that its security interest includes after acquired equipment; and

(c) TCE did not subordinate its prior perfected security interest in the Machines in favour of Engel's interest either contractually or by conduct.

The Factual Overview

9 TCE agreed to provide credit facilities to Renwel by way of a Demand Revolving Loan in the amount of $1,100,000 and a Demand Installment Loan in the amount of $1,300,000. These loans were in accordance with the terms and conditions set forth in a written Offer to Finance dated January 23, 2001 (the "January Loan Agreement") and amended between the parties on July 18, 2001 (the "July Loan Agreement").

10 In January 2001 Renwel purchased a machine that is not the subject of this application. CIT provided financing for its purchase. CIT registered its security interest pursuant to the PPSA on February 5, 2001. CIT's priority in this machine is acknowledged by the respondent.

11 The respondent acknowledges that if CIT had provided the financing for the acquisition of the Machines as anticipated, CIT would have had priority to the interests of TCE due to its prior PPSA registration.

12 Commencing on February 9, 2001 and from time to time thereafter, TEC advanced monies to Renwel in accordance with the terms of the January Loan Agreement.

13 To secure payment of the obligations of Renwel to TCE, Renwel granted to TCE a general security interest in all of Renwel's present and after acquired personal property further to a General Security Agreement executed by Renwel on April 3, 2001 (the General Security Agreement).

14 By the terms of the General Security Agreement, Renwel granted to TCE a security interest in existing collateral in which Renwel had an interest at the time of execution of the General Security Agreement, as well as after acquired collateral.

15 The General Security Agreement provides further that:

14.15 The Security Interest created hereby shall attach when this Security Agreement is signed by the Debtor and delivered to the Creditor. The Debtor and the Creditor acknowledge that value has been given and the Debtor has rights in the Collateral now owned by the Debtor and that the Security Interest shall attach to the Collateral acquired after the date hereof as soon as the Debtor has rights in such Collateral. [emphasis added]

16 The Applicant acknowledges that it did not have the super security of a PMSI due to Engel's failure to register the security agreement within 10 days of shipping the Machines.

17 Clearly, by the terms of paragraph 14.15 of the General Security Agreement, the security interest in favour of TCE attached unless TCE subordinated its rights to the machines as excluded after acquired property.

18 A secured creditor may subordinate its priority pursuant to section 38 of the *Personal Property Security Act*, R.S.O. 1990, c.P.10 "in the security agreement *or otherwise*"

19 The issue, therefore, is whether TCE subordinated its security interest in the Machines in favour of Engel in the security agreement, "or otherwise".

The Parties' View of Subordination

20 Engel takes the position that a finding should be made that TCE subordinated its security interest to Engel.

21 Although there is no specific subordination clause in the General Security Agreement that uses language of "rank" or "priority", the applicant asserts that the specific exclusion of purchase money liens from the representations, warranties and covenants in the General Security Agreement is implicit subordination of TCE's priority. Second, this implicit subordination is clarified by the explicit terms of the July Loan Agreement, which uses the words "first charge" and "second charge". Finally the affidavit evidence and evidence given on cross-examination is clear that TCE never anticipated or intended to have security in the Machines, which were not being financed by TCE.

22 The Respondents, on the other hand, argue that the terms of the General Security Agreement are clear, and should be considered in isolation from extrinsic evidence. Counsel submits that neither the terms of the January or July Loan Agreements are relevant to the inquiry. There is no ambiguity in the General Security Agreement, and hence no need to consider extrinsic evidence. Alternatively, if extrinsic evidence is to be considered, any evidence of intention to subordinate relates to leased machines, not machines shipped by a manufacturer such as Engel. TCE asserts that, for a third party to take advantage of subordination, the terms must be clear and unequivocal. Such clarity of terms, so the respondent argues, is lacking in this case.

The Admissibility of Extrinsic Evidence

23 The respondent argues that the General Security Agreement alone should be considered as extrinsic evidence is not necessary to clarify its terms. I do not agree with this assertion.

24 Ordinarily in assessing issues of interpretation of contracts, the parole evidence rule applies. Extrinsic evidence is admissible only for clarification in cases of ambiguity. However, in this circumstance I conclude that the parole evidence rule does not apply. The terms of section 38 of the PPSA, and the cases considering that section, confirm that extrinsic evidence may be considered to determine whether a secured party has subordinated its secured interest in the security agreement "or otherwise". The caselaw is clear that priority interests may be subordinated without a specific clause in the governing contracts as proved by extrinsic evidence. See *Royal Bank v. Tenneco Canada Inc.* (1990), 9 P.P.S.A.C. 254 (Ont. H.C.), *Furmanek v. Community Futures Development Corp. of Howe Sound* (1998), 14 P.P.S.A.C. (2d) 1 (B.C. C.A.).

25 If contested factual issues arise, the question of subordination may be heard as a trial of an issue. Any other interpretation with respect to the admissibility of extrinsic parole evidence renders the words "or otherwise" meaningless.

26 From an evidentiary perspective, I conclude that when more than one document or affidavit evidence may be considered to determine the issue of subordination, a sequential approach with respect to admissibility is appropriate.

27 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, if after reviewing all 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 admissable and relevant to the inquiry. The factual inquiry may well have to take place in the context of a trial if essential facts are contested. I suggest this approach is consistent with the principles outlined by Morden J.A. in *Sperry Inc. v. Canadian Imperial Bank of Commerce* (1985), 4 P.P.S.A.C. 314 (Ont. C.A.) that the starting point is the governing security agreement.

28 I conclude therefore that if there is no subordination clause in the General Security Agreement, then the contractual terms of both the January and July Loan Agreements, and the affidavit evidence and cross-examinations may be relevant evidence admitted in sequence to determine whether TCE subordinated its priority in the Machines to Engel.

The Terms of the General Security Agreement

29 The General Security Agreement provides that TCE acquires priority in after acquired equipment, which *prima facia* would include the Machines.

30 However, the representation and warranty provisions of the General Security Agreement excludes from the warranty provisions the permitted encumbrances as specified in Schedule A, which includes purchase money liens. It is acknowledged that Engel has a purchase money lien with respect to the Machines, but it does not have the super security of a PMSI due to its failure to register.

31 The representation and warranty provisions provide:

(a) The Collateral is genuine and owned by the Debtor free of all security interests, mortgages, liens, claims, charges, licenses, leases, infringements by third parties or other encumbrances (hereinafter collectively called "Encumbrances"), save for the Security Interest and those Encumbrances shown on Schedule "A" hereto or hereafter approved in writing, prior to their creation or assumption, by the Creditor) hereinafter collectively called ("Permitted Encumbrances"). [emphasis added]

32 As well, the covenant of the debtor to keep the collateral clear from encumbrances excludes Schedule A permitted encumbrances:

4.01 So long as this security agreement remains in effect the Debtor covenants and agrees:

(a) to defend the Collateral against the claims and demands of all other parties claiming the same or an interest thereon; to keep the Collateral free from all Encumbrances, except for the Security Interest and those shown on Schedule "A" hereto ...

33 I note that the relevant clause in Schedule A does not refer to a "purchase money security interest" [which necessarily implies registration within 10 days of shipping the collateral] but rather a purchase money lien. Schedule A provides:

Schedule A to the foregoing General Security Agreement Encumbrances

Personal Property Security Act (Ontario)

4. Purchase money liens, conditional sales agreements or other title retention instruments, charges, hypothecs, pledges, liens or other encumbrances created, issued or assumed to secure the unpaid purchase price in respect of such property or asset. [emphasis added]

34 Do these clauses in the General Security Agreement considered together constitutesubordination, having regard to the principles developed in the caselaw?

Governing legal principles

35 A review of the caselaw reveals a spectrum of circumstances to determine the question of subordination.

36 The easiest and clearest of cases is when there is a subordination clause in the governing security agreement using the key words "priority" or "rank". *Euroclean Canada Inc. v. Forest Glade Investments Ltd.* (1985), 4 P.P.S.A.C. 271 (Ont. C.A.) at p. 74 represents this clear case. Its general security agreement allowed liens in connection with the acquisition of property, and specified that "such... lien or other encumbrance shall rank in priority to the charge hereby created".

37 The language used in *Sperry Inc. v. Canadian Imperial Bank of Commerce* (1985), 4 P.P.S.A.C. 314 (Ont. C.A.) is at the other end of the spectrum. The permissive language in the warranty and representation clauses was held not to constitute an agreement to subordinate. The Ontario Court of Appeal had to construe the following clause in *Sperry* in the warranty and representation clause of the security agreement:

> The undersigned [debtor] represents and warrants that, except for the security interest created hereby and except for purchase money obligations, the undersigned is, or with respect to Collateral acquired after the date hereof will be, the owner of Collateral free from any mortgage, lien, charge, security interest or encumbrance. "Purchase money obligations" means any mortgage, lien or other encumbrance upon property assumed or given back as part of the purchase price of such property, or arising by operation of law or any extension or renewal or replacement thereof upon the same property, if the principal amount of the indebtedness secured thereby is not increased. [emphasis added]

38 There was no parallel exclusion in the covenants of the security agreement. Morden J.A., for the Court, held that this clause did not demonstrate any agreement by the bank to subordinate its interest to the supplier, and contrasts the clause in question to that found in *Euroclean*.

39 The reasoning in *Sperry* was adopted in *Asklepeion Restaurants Ltd. v. 791259 Ontario Ltd.* (1996), 11 P.P.S.A.C. (2d) 320 (Ont. Gen. Div.); aff'd (1998), 13 P.P.S.A.C. (2d) 295 (Ont. C.A.). The Court held that a clause in a general security agreement was not a true subordination agreement since the wording of the clause was not expressly to that effect. The wording of the general security agreements given in favour of the defendants in *Asklepeion* fell within the ambit of *Sperry*. There was no express clause that the encumbrances shown in a schedule would have priority.

40 In between these two extremes of the spectrum, is the language of the security instrument found in *Chiips Inc. v. Skyview Hotels Ltd.* (1994), 27 C.B.R. (3d) 161 (Alta. C.A.). In *Chiips*, the agreement prohibited the debtor from creating any lien ranking in priority to the general security agreement, but that this covenant did not apply to prevent permitted encumbrances which included a purchase money lien, provided that the lien secured only the property being acquired.

41 The relevant clause provides that the debtor in *Chiips* was prohibited from creating:

> ... any... lien or other encumbrance on 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:
>
> the assuming or giving or purchase money mortgages or other purchase money liens on property 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 thereon 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;...

41 The majority of the Alberta Court of Appeal held that the language in the above clause demonstrated an intention by the secured party to subordinate its security to future PMSI's created by the debtor. The wording of the governing clause in the *Chiips* decision is clearer than the applicable clause in this case, as specific mention is made of an encumbrance "purporting to rank in priority" to the security in the general security agreement.

42 The respondent argues that *Chiips* is not binding law in Ontario, and that it takes too liberal a view of what constitutes an agreement to subordinate, in light of the certainty of a PPSA system governed by the timing of registration.

43 Respectfully, I disagree.

44 The Ontario Court of Appeal in *Canadian Imperial Bank of Commerce v. Otto Timm Enterprises Ltd.* (1995), 26 O.R. (3d) 724 (Ont. C.A.), at 728 has cited *Chiips* with approval, but distinguished *Chiips* and *Euroclean* on the facts of that case.

45 The Respondents rely upon the decision of *Sperry* to support their argument that there is no clear subordination clause. In my view the decision of Morden J.A. in *Sperry* may be distinguished. In that case the exclusion applied only to the representations and warranties. There was no schedule of exclusions specifically limiting the scope of the lender's security. There was no specific exclusion contained in the covenant in the general security agreement in *Sperry* as there is in this case.

46 I note that similar wording to the clauses in this case is used to support a finding of an agreement to subordinate in *Bank of Montreal v. Dynex Petroleum Ltd.* (1995), 11 P.P.S.A.C. (2d) 291 (Alta. Q.B.). The Court reviewed the terms of the original general assignment, and the subsequent loan agreements and the debenture. The Court concluded that the governing clauses, including the covenant clauses clarified in a schedule of exclusions constituted an agreement to subordinate.

47 Rooke J. in *Dynex* concluded, after an extensive analysis of the law of subordination and an analysis of the clauses in question:

> Applying the principle [in Chiips] to this case I find that the clauses in question to which I have referred ...contemplate a subordination of the debenture holder's interest to the previously granted interests to the overriding royalty and net profit interestholders. Not implicitly, but explicitly, they allow those holders to rank ahead of the debenture holders in regards to those particular interests, and indeed, any others specifically consented to by the Bank in the future. Equally consistently, the commercial reality in the oil and gas industry, in conjunction with the financial industry, requires that documents of this nature be given that effect. [emphasis added]

48 Two commercial principles need to be considered. First, predictability and certainty must be maintained, particularly in the context of a PPSA regime. Second, clauses must be interpreted using the common sense plain meaning of the words, having regard to the practicalities of a commercial enterprise.

49 With respect to the first principle, I adopt the concerns enunciated by Winkler, J. in *Sun Life Assurance Co. of Canada v. Royal Bank* (1995), 10 P.P.S.A.C. (2d) 246 (Ont. Gen. Div. [Commercial List])

> The P.P.S.A. provides a registration regime, the purpose of which is to impart order and certainty to commerce. To the extent that s. 38 of the Act provides an exception to this, it must be applied by the courts cautiously. Although the waiver of priority may, on the plain wording of the section, be contained in the "security agreement or otherwise", it must, nevertheless, be in clear and unequivocal terms. Hence the words of the section that "such subordination is effective according to its terms". Waiver requires that there be full knowledge of the circumstances and the unequivocal intention to relinquish the right to be relied upon. See *Federal Business Development Bank v. Steinbock Development Corp.* (1983), 42 A.R. 231 (C.A.).

50 The Respondents' counsel submits that the PPSA regime is an absolute one and a participant must "live by the sword" and "die by the sword". Clearly principles of predictability are important. However, these principles must be balanced by the intention and practical necessity of subordination clauses in the context of the commercial enterprise. I adopt the principles enunciated by Harradence J.A. in *Chiips*, *supra* at page 179:

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.

51 Schedule A confirms existing exclusions as at the date of the General Security Agreement, as well as future exclusions. It permits future "*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 explicitly permits and anticipates future encumbrances, although wording with respect to priority or rank is not used.

52 In my view, the applicable clauses of the General Security Agreement including Schedule A, when read together are more similar to the governing clauses in *Chiips* than those in *Sperry*.

53 The provisions of the General Security Agreement particularly the covenant provisions when read with Schedule A clearly allow the debtor to purchase specified encumbered assets including purchase money liens. According to the *Encyclopedia of Words and Phrases Legal Maxims Canada, 4th ed, Vol. 2*, "encumbrance" means "a claim, lien or liability that is attached to property". Allowing the purchase of specified encumbered assets without granting priority in the encumbrance appears to be a hollow right that does not make commercial sense unless subordination is implicit.

54 I conclude therefore that Engel's purchase money lien does have priority to the interests of TCE when considering only the terms of the General Security Agreement based upon an analysis of the clauses in question, and distinguishing these clauses from the applicable clauses in the *Sperry* decision. If I am incorrect in my conclusion reached, then any doubt about the absence of wording "priority" or "rank" is squarely answered by the terms of the July Loan Agreement which governs TCE's loan. It uses the clear language of "first charge" and "second charge".

The Loan Agreement

55 Both the January and the July Loan Agreements confirm that their terms do not merge with those of the General Security Agreement.

56 The January Loan Agreement provided a term with respect to the intended scope of the first charge:

> The liability and obligation herein and <u>any future obligations</u> of any nature and kind of the borrower and the guarantors, TCE shall be evidence, governed and secured, as the case may be, by the following documents (collectively the "Security") completed in form and manner satisfactory to TCE's lawyers:
>
> 1. ...
>
> 2. General Security Agreement of the Borrower, <u>1st charge on accounts receivable and inventory, and designated equipment (list to be provided)</u>. [emphasis added]

57 It is acknowledged that TCE did not ever receive a list of "designated equipment". What is meant by "designated equipment" was clarified in the cross- examinations to include some existing equipment owned by Renewal that was not subject to third party financing. In any event, the meaning of this clause is not relevant to this inquiry apart from background, in light of the clarification in the amendments found in the July Loan Agreement.

58 That term with respect to the scope of TCE's first charge was amended unilaterally by TCE in the July Loan Agreement. At this time further funds were being advanced by TCE to allow Renwel to finance the purchase of a building. Mr. Desormo, a former banker and officer with TCE made the revisions to TCE's loan agreement. The July Loan Agreement provides:

The liability and obligation herein and any future obligations of any nature and kind of the Borrower and the Guarantors, TCE shall be evidence, governed and secured, as the case may be, by the following documents (collectively the "Security") completed in form and manner satisfactory to TCE's lawyers

2. General Security Agreement of the Borrower, 1st charge on accounts receivable and inventory, and all unencumbered equipment, and a 2nd charge on remaining encumbered equipment. [emphasis added]

59 Curiously, the existence of the amendments to the Loan Agreement was not initially disclosed, as the July Loan Agreement was not included in the original motion material.

60 No changes were made to the General Security Agreement dated April 3, 2001 after the July 2001 amendments to the Loan Agreement.

61 Although the words "rank" and "priority" are not used in the amended Loan Agreement, I conclude that reference to a "first charge" and "second charge" is clear unambiguous language that constitutes explicit acknowledgement by TCE of subordination of first rank and priority on encumbered equipment.

62 Clearly the Machines are "encumbered equipment" as Renwel had signed security agreements in favour of Engel when the Machines were shipped.

63 If the terms of the General Security Agreement on their own are not sufficient to constitute subordination, then I conclude that there is a clear agreement to subordinate security on encumbered equipment, when those terms are read with the July Loan Agreement.

The affidavit evidence and cross-examinations

64 I conclude that I am able to determine the motion based upon the documents alone. In my view it is not necessary to consider the affidavit material and the cross-examinations, given my earlier conclusions, and utilizing a sequential approach to the admissibility of the evidence. However, if this matter is reviewed by another Court, I will briefly outline this additional evidence, which in my view simply confirms my earlier conclusions.

65 It does not appear that the facts are in dispute. If I had concerns about disputed facts, I would have required limited cross-examination before me on those factual areas requiring clarification, or I would have referred the matter to the trial of an issue.

66 Mr. Desormo, an officer of TCE, acknowledges that he knew the Machines would be acquired and financed externally. He admits on behalf of TCE that TCE's intention was that CIT would have a first charge having priority over TCE in relation to the Machines and TCE therefore did not negotiate with Renwel or CIT to obtain a first charge on this equipment.

67 The evidence of Mr. Desormo with respect to the July Loan Agreement amendments is telling. He states that the revision "just showed the ranking" and was "just to clarify exactly what we expected our position would be with respect to equipment". He confirmed that TCE had security "covering all assets" but "a second place on encumbered equipment".

68 Clearly TCE knew that Renwel would be acquiring the Machines. They were intended to be financed by a lease. Mr. Desormo gave evidence that the encumbered equipment was limited to leased equipment, as distinct from encumbered equipment secured in favour of the manufacturer. I note that this assertion is contrary to the clear unqualified words of the January Loan Agreement.

69 Mr. Desormo and Mr. Welsh, President of Renwel, did not discuss the revision. Mr. Desormo stated that he did not think there was any specific reason to discuss it, and Mr. Welsh, president of Renwel did not think there was anything wrong with the clarification.

70 Mr. Welsh confirms that "the concept was that [TCE] would have security over everything that the lease company didn't". Due to financial difficulties, Renwel did not make the required 20% deposit on the purchase price of the Machines. Due to the inadequate deposit, and perhaps other reasons, CIT declined to provide the anticipated financing.

71 Mr. Rieder's affidavit in my view should be ignored. Mr. Rieder, on cross-examination of his affidavit, admitted that he did not have any direct dealings or involvement in discussions and negotiations between Renwel and TCE regarding TCE's financing. He purports to give evidence as to the common intention of the parties when he is in no position to do so. Had he participated at the time, and if the common intention of the parties was in dispute, this is the type of issue that should be tested by cross-examination before a judge.

Summary of Conclusions

72 The parole evidence rule does not apply in determining issues of subordination, due to the wording of section 38 of the PPSA which provides that subordination may occur in the security agreement "or otherwise".

73 A sequential approach to determine issues of admissibility of extrinsic evidence is appropriate. 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, if after reviewing all 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 and relevant to the inquiry.

74 I conclude by the terms of the General Security Agreement that TCE subordinated its priority to Engel, even though specific words of "priority" and "rank" are not used. The clauses in question resemble those found in the *Chiips* decision, and I conclude that *Sperry* can be distinguished. In interpreting the meaning of the governing clauses, principles of commercial predictability must be respected, in the context of the commercial reality of an enterprise carrying on business.

75 Any doubt about rank and priority and subordination is clearly resolved by the terms of the July Loan Agreement. It specifically confirms that TCE has a "first charge on accounts receivable and inventory, and all unencumbered equipment, and a second charge on remaining encumbered equipment". By the terms of the General Security Agreement, the Machines are encumbered equipment. Engel has a first charge on the Machines.

76 It is not necessary in this case to consider the affidavit material, and the cross-examinations in reaching my conclusions, as in my view the governing documents are clear and determinative. A review of the additional material serves only to confirm my earlier conclusions. If I had been relying upon the affidavit material, and if the facts were contested, then I would have either heard cross-examination on the contested factual issues, or referred the matter for the trial of an issue.

77 For these reasons, the applicant's motion is granted. I thank counsel for their submissions. If the parties are unable to resolve the issue of costs, the parties may submit brief written submissions to me within 14 days of the release of these reasons.

Order accordingly.

END OF DOCUMENT

Indexed as:

Fairline Boats Ltd. v. Leger

Between
Fairline Boats Ltd., plaintiff, and
Robert Leger, and Robert Leger and Carmen Denise Leger,
carrying on business under the firm name and style of Leger
Sports Centre, defendants

[1980] O.J. No. 216

Supreme Court of Ontario - High Court of Justice
District of Sudbury
Linden J.

Oral judgment: November 10, 1980
(23 pp.)

Counsel:

R.G. Renzini, for the plaintiff.
M.G. Woods, for the defendants.

¶ 1 **LINDEN J.** (orally):— This is an action in which the plaintiff, a boat manufacturer, seeks possession of a 22-foot cabin cruiser from the defendant boating dealer who claims to have purchased it "in the ordinary course of business" from a third person, Blair, who was the original purchaser of the boat.

¶ 2 The plaintiff contends that the Personal Property Security Act provisions were complied with and that the defendant purchased the boat from Blair subject to the interests of the plaintiff, notice of which was duly registered, and that Leger must therefore return it. The Fairline Holiday 22-foot silvergray cabin cruiser which is the subject of this litigation was built by the plaintiff in the Spring of 1979 and sold to Blair Mower Marine and Cycle for $24,379.99, including many accessories. A conditional sales contract dated July 5th, 1979 was entered into and this contract was assigned to Finance America Private Brands Limited, which is a financing organization that deals in such matters.

¶ 3 The purchaser, Blair, had earlier entered into a Security Agreement dated December 7th, 1978 with Finance America, which covered all Fairline boats located at Blair's place of business, 6595 Drummond Road in Niagara Falls, Ontario. A financing statement was registered pursuant to the Personal Property Security Act against the inventory of Blair Mower and against Blair personally on December 13th, 1978, and this was amended slightly on December 18th, 1978 in a document registered on that day. In the Fall of 1979 Blair Mower went into default on its obligation to Finance America. Finance America, in a letter dated September 26th, 1979 recommended to Fairline that they repossess the cabin cruiser. This was done immediately by Fairline, who took the boat away from Blair and placed it at Dawson's Marina at Keswick, Ontario, on September 8th, 1979, in the hope that it could be sold by Mr. Dawson for a 10 percent commission during a sale of boats that was taking place there at that time.

¶ 4 John Blair somehow retrieved the cabin cruiser from Dawson's Marina in early October and purported to sell it to the defendant, Leger. The boat was placed on Leger's business premises in St. Charles, Ontario, near Sudbury. When this was discovered by Finance America, they attended, along with an officer of Fairline, at Leger's place of business and tried to repossess the boat. Leger refused to deliver it up, insisting that he had legally purchased it from Blair for $15,000.00 and that he was entitled to keep it.

¶ 5 Following this, an assignment agreement was entered into on October 16th, 1979, whereby Finance America assigned its rights under the Conditional Sales Agreement back to Fairline in return for payment in full of the amount owing, $25,494.01, which was the full price of the boat including interest charges until that date. This action was

commenced on October 26th, 1979, by Fairline to retrieve the cabin cruiser, or in the alternative, for damages, but counsel has elected to seek the return of the boat rather than any damage award.

¶ 6 Although the defendant made some technical arguments in relation to the validity of the security under the Personal Property Security Act, I find that there were no irregularities such as to render invalid the claim of the plaintiff. I also find that the security was perfected in accordance with the Personal Property Security Act, and that the interest of Finance America was properly transferred to the plaintiff to enable it to bring this action.

¶ 7 The key issue in the case then is whether the sale to Leger by Blair was one which was "in the ordinary course of business" so as to come within section 30 sub-section 1 of the Personal Property Security Act, which reads as follows:

> "A purchaser of goods from a seller who sells the goods in the ordinary course of business takes them free from any security interest therein given by his seller, even though it is perfected and the purchaser actually knows of it."

If the sale was in the ordinary course of business, then Leger received clear title, even though the security interest was registered. If it was not in the ordinary course of business, then Leger took subject to the interest of the plaintiff, since the registration of the document took place on December 13th, 1978, and December 18th, 1978, long before the date of this sale to Leger on October 3rd, 1979, or such other date in that period as the sale actually took place upon.

¶ 8 The objective of this section, as I understand it, is to permit commerce to proceed expeditiously without the need for purchasers of goods to check into the titles of sellers in the ordinary course of their business. Purchasers are allowed by our law to rely on sellers using the proceeds of sales to repay any liens on the property sold. In these days inventory is almost invariably financed, and as a result is almost invariably subject to liens of one kind or another. To require searches and other measures to protect lenders in every transaction would stultify commercial dealings, and so the Legislature exempts buyers in the ordinary course of business from these onerous provisions, even where they know that a lien is in existence. The risk is placed on lenders of an occasional dishonest dealer who may sell some of his goods in the ordinary course of business and then fail to repay the debt because "he is in a much better position than the buyer to weigh the risks." (See the monumental article by Professor Jacob Ziegel, "The Legal Problems of Wholesale Financing Of Durable Goods in Canada (1963) 41 Canadian Bar Review 54 at page 85.) Some protection is given to security holders by denying reliance on this section to those who do not buy in the ordinary course of business.

¶ 9 What then is a sale "in the ordinary course of business"? Mr. Fred Katzman et al in the book, Personal Property Security Law in Ontario (1976) explains that this language was taken from the older predecessor legislation and from the jurisprudence based thereon which used such language as "ordinary" or "regular" or "usual" course of business. Katzman suggest at page 144:

> "The person whose conduct claims to come under the description must be engaged in carrying on a business. That business must involve as subject of traffic things of the class in which the item dealt falls, and the basis of dealing must be on the normal terms of dealing with that class of item in that type of business. The general commercial practice, rather than the dealer's particular operating method is the criteria.... The market for goods is the public at large buying for a variety of purposes, non-business as well as business, and the buyer should not be called on to show more than what he bought in the same way as the seller's customers generally."

¶ 10 The authorities on the new Act are non-existent, and even the older authorities are slim indeed, but cases decided before the new Personal Property Security Act have held that there is an implied authority to sell encumbered goods as long as it is in the ordinary course of business. (See McRuer, C.J.H.C. in Insurance and Discount Corporation v. Motorville [1953] O.R. 16). If sales are made in fraudulent circumstances in order to abscond with the proceeds, a Court may hold that this is not within the implied authority of the seller. (Ibid). Similarly if a car dealer sells five cars to another car dealer for the express purpose of raising money to lessen the financial pressure that he was under at the time, this was held not to be a sale in the ordinary course of business and a search must be made by the buyer to protect himself. (See MacDonald v. Canadian Acceptance Corporation [1955] O.R. 874 (C.A.)) The Court felt that

> "a few such sales for such purpose would be materially to impair the mortgage security, if not destroy it altogether. A license calculated to bring about such a devastating result is not to be imported into the instrument in derogation of the terms creating the security."
> (See Aylesworth J.A. at page 882.)

So too, when a car is sold without delivery of a transfer of the ownership permit at the time, or shortly thereafter, this has been held not to be a sale in the ordinary course of business. (See Rider v. Bank of Montreal [1965] 1 O.R. 2d. 69.)

¶ 11 On the other hand cases have held that the pledging of goods by a factor can be in the ordinary course of business. (Peoples Credit Jewellers v. Melvin [1933] O.W.N. 76.) Furthermore, a sale of a car by one used car dealer to another can also be a sale in the ordinary course of business. (See Lipman v. Traders Finance [1951] O.W.N. 838.) This may be so even if the purchase is after hours and is also for a substantial quantity sold to another dealer with whom the seller had previous dealings. (See also Pacific Motor v. Motor Credits [1965] 2 ALL E.R. 105, P.C., 29 cars sold but under a different statutory regime.)

¶ 12 Thus in deciding whether a transaction is one that is in the ordinary course of business, the Courts must consider all of the circumstances of the sale. Whether it was a sale in the ordinary course of business is a question of fact. (See the Ziegel article, Supra, at page 86.) The usual, or regular type of transaction that people in the seller's business engage in must be evaluated. If the transaction is one that is not normally entered into by people in the seller's business, then it is not in the ordinary course of business. If those in the seller's business ordinarily do enter into such agreements, then, even though it may not be the most common type of contract, it may still be one in the ordinary course of business.

¶ 13 One factor that must be examined is where the agreement is made. If it is at the business premises of the seller it is more likely to be in the ordinary course of business. If it is away from the business premises of the seller, in suspicious circumstances for example, a Court may hold that it is not in the ordinary course of business.

¶ 14 The parties to the sale may also be significant, although certainly not controlling. If the buyer is an ordinary, everyday consumer, the likelihood of his being involved in a sale in the ordinary course of business is greater. If the buyer is not an ordinary consumer, but a dealer or financial institution, then the Court may take this out of the ordinary course of business, but not necessarily so because dealers and other too may, in proper circumstances, receive the benefit of the provision.

¶ 15 The quantity of the goods sold must also be considered, although this too is not definitive. If there is only one or a few articles sold in the ordinary way, the Court is more likely to hold this to be a sale in the ordinary course of business. On the other hand, if a large quantity of items are sold, many more than are sold in the ordinary course of business, and perhaps forming a substantial proportion of the stock of the seller, then the Court is less likely to consider it to be in the ordinary course of business.

¶ 16 The price charged for the goods must also be examined, thus if the price charged is in the range of the usual market price, Courts are more likely to consider the sale in the ordinary course of business, whereas if the price is unduly low, the Courts may hold that this is not a transaction in the ordinary course of business.

¶ 17 There are other circumstances and factors in each sale that may also be viewed by the Court in determining whether, on all of the facts of the case, the sale in question is in the ordinary course of business.

¶ 18 The facts on this issue are in dispute in several of their important aspects. The defendant, Leger, testified that he met Blair at the boat show at Ontario Place in Toronto in September of 1979. He had, earlier, on September 15th, 1979, contracted to buy several boats, including one Fairline 22-foot Holiday cabin cruiser from the plaintiff's representative at Ontario Place, for $16,095.44 cash. (See Exhibit 12). Blair told Leger that he would sell him a similar boat, which he had on display at Ontario Place at that boat show, for less, and Leger became interested. After the boat show, Leger testified that he telephoned Blair at his place of business in Niagara Falls and discussed further the purchase of the 22-foot boat. At first they discussed a price of $16,500, but then the price was lowered to $15,000, which Leger felt was a pretty good deal. The boat, he thought, was used, since it was somewhat scratched and had 68 hours of use on its odometer. The Blair boat had more accessories and two Volvo engines and was somewhat heavier than the one that Leger had contracted to buy from Fairline. Leger testified that he travelled to Niagara Falls and completed the deal there, paying $15,000 in cash and receiving a Bill of Sale dated October 3rd, 1979 from Blair. Leger said that he carried a one and a half inch thick envelope full of $100 bills in a suitcase to Niagara Falls and handed it over to Blair in return for the boat. Leger said that he always dealt in cash since a sale was final if that was so, and there were no questions about it. A secretary in the law office of Leger's lawyers verified that he indeed did conduct business generally with cash and that he had recently brought in a large amount of cash to complete a real estate deal with the firm.

¶ 19 Leger testified that he got the money to pay Blair partly from a loan of $10,000 from the Bank of Nova Scotia. A bank note dated September 19th, 1979 for $10,000 was introduced as exhibit number 17. Leger thought that the deal was made on a Saturday, but the Bill of Sale actually said October 3rd, which was a Wednesday, not a Saturday. Leger indicated that he could not recall the actual day of the week that he went to Niagara Falls, since he worked seven days a week and every day was the same to him. Leger also testified that Blair delivered the boat to him in St. Charles, near Sudbury, the same day that he bought it; that is, October 3rd, on a trailer and left both the boat and the trailer on his business premises. Leger also said that Blair never told him that he was in any financial difficulty, only that he wanted to reduce his summer stock and get winter inventory, something that is not uncommon in the boat selling world. In cross-examination he admitted that he knew that Blair was "liquidating his stock", but by this I think he merely meant to say the same thing. Blair never indicated to him that he owed any money on the boat and Leger never searched the records in order to check this. He said he never searched if he bought from a dealer, but only did so if he was purchasing from an ordinary customer, as in the case of a trade-in.

¶ 20 When the people for Finance America and Fairline came to St. Charles to reclaim the boat from Leger, he told them that he had bought it for $15,000 and that he would not give it up without repayment of what he had paid for it. He said that their problem was with Blair to whom they should look for payment and not to him. Leger also testified that it was common for dealers to sell to each other boats to reduce their stock at the end of the season, or if they needed a particular boat which another dealer had. He said he sold 10 boats to Sudbury Boat and Canoe for $50.00 less than cost to reduce his own stock last year. Mr. Scott of Sudbury Boat and Canoe confirmed this in his testimony. He also said that it was not unusual for dealers to buy and sell boats from other dealers. Mr. Scott also indicated that he, as a boat dealer, does not do any searches if he is dealing with another dealer, although he did admit on cross-examination that there may have been some risk in this practice.

¶ 21 The evidence of the plaintiff differed from that of Leger as to the circumstances of this sale by Blair. Mr. Allen Jones, the president of the plaintiff company, testified that, when he received Finance America's letter of September 26th, 1979, he called Blair and told him that be would have to repossess the 22-foot boat (along with another one). On September 28th, 1979, Jones says that the boat was taken to Dawson's Marina, Keswick, Ontario, where Mr. Dawson was to try and sell it for a 10 percent commission. He did not authorize Blair or anyone else to remove the boat from the Dawson Marina. He insisted that dealers of boats do not sell to one another, nor do dealers trade to one another. He also asserted that the boat in question was not a used boat, but was still new and worth its full value, even though there were 68 hours on the odometer and that it had been kept in the water for a while at Dawson's Marina.

¶ 22 Mr. Dawson, of Dawson's Marina, testified to the effect that his company undertook to try and sell the 22-foot boat repossessed from Blair, which was delivered to him on September 28th. He was not a Fairline dealer himself but he had been in the boat business for some 50 years. He said he placed the boat into the water and tried to sell it. On Saturday night, he testified that he took his wife out to dinner and that, when he returned, he saw a truck coming out of his driveway. The driver of the truck said that he was Blair, whom Dawson had met before at boat shows. Blair said that he was looking for a 22-foot boat which he thought had been brought up there on a trailer. Dawson agreed to help Blair find the trailer and the boat, but they were unable to locate it at night in the rain. Dawson said that he suggested to Blair that he call Fairline on the telephone but Blair said that he did not want to bother them on a Saturday night. Blair said that he would stay in the area and get a trailer and pick up the boat. The next morning when Mr. Dawson was doing his rounds at ten a.m. he noticed that the 22-foot Fairline boat had been taken from his marina. Dawson stated that the date of these events was Saturday, October the 6th, and Sunday, October the 7th, 1979. He also agreed that $15,000 was too low a price for this boat, which he said he would never sell below cost. His estimate of the market value of the boat was $25,000 to $28,000. It was also not a used boat according to him. Dawson testified also that he never purchased boats from other dealers nor sold to other dealers, except on occasion to his neighbour and competitor, and except that he sold parts occasionally to other boat dealers.

¶ 23 Dale Proulx of Finance America testified about the dealings with Fairline and Blair. He said that he had advised Fairline to repossess the 22-foot boat on September 26th, 1979 since Blair's business was failing, and which Fairline subsequently did. When the boat was reported missing from Keswick on October 10th, he went to the Niagara police and through them learned that the missing boat and the missing trailer were in the possession of Leger in St. Charles. Mr. Proulx, along with Mr. Vit of Fairline, went up to St. Charles in the Fairline 3/4 ton pickup truck on October the 11th and 12th and saw the boat and trailer there. He says that the trailer's serial number had been filed off. They had some discussions with Leger about the boat and he said that he had bought it for $15,000 from Blair. Proulx also said that Leger told him that he had picked the boat up in Keswick at a restaurant. Leger refused to return the boat and denied defacing the trailer. He said that he expected to return the trailer to Blair when he was through with it. Disappointed, Proulx and Vit returned to Niagara Falls leaving the boat behind, but they did take the trailer back with them on the truck.

¶ 24 Leger, when cross-examined about this, denied that he had said that he had picked up the boat in Keswick, or that he had in fact picked it up in Keswick. Confirming his own evidence in all respects, he stated that he had never been in Keswick and did not even know where it was.

¶ 25 On all of this conflicting evidence I find the facts to be as follows:

¶ 26 I accept the evidence of the plaintiff as more reliable and more plausible than that of the defendant. In my view Mr. Leger was very interested in the outcome of this litigation. His demeanour was belligerent and vague where it suited him, and the story that he told, in my view, was just not plausible in all of the circumstances. The plaintiff's witnesses were specific and credible, in my view.

¶ 27 I find that the sale to Leger was actually made on Sunday, October 7th.

¶ 28 I do not believe that the price Leger paid was $15,000 in cash, but that he paid something less, perhaps in the $10,000 range. The Blair invoice is not a credible document since the date on it indicating a $15,000 price was October 3rd, which I find was clearly a false date. The price listed on the document I find was not the actual one paid. I can not rely on Blair's honesty with regard to the accuracy of this invoice, because he was dishonest and totally unreliable. Also Leger's story about carrying $15,000 in $100 bills in a suitcase is implausible, in my view, and he cannot be believed, nor is he reliable as to amounts or dates.

¶ 29 The loan that was taken at the bank on September 19th, was only for $10,000. If it was truly a deal for $15,000, (or $16,000 as the original deal with Fairline was to be) the loan would probably have had to be a larger one, closer to the full value of the transaction in the usual course.

¶ 30 I find that the place of the transaction was not the Niagara Falls business address of Blair at all, but somewhere else, either in Keswick, or near Keswick, or somewhere between Keswick and St. Charles, or perhaps even in St. Charles itself. It would make absolutely no practical sense for Blair to pick up the boat and trailer that he was to sell and deliver to Leger in St. Charles, 250 miles or so north of Keswick late Saturday night, October 6th, or early Sunday morning, October 7th, and then drive with the boat all the way back to Niagara Falls, and then, after dealing with Leger there, drive the boat and the trailer all the way back past Keswick to St. Charles all on the same day. The distance from Keswick to Niagara Falls is approximately 125 miles, and the distance from Niagara Falls to St. Charles is approximately 400 miles. It would have been much more reasonable and normal to take the boat and trailer right up to St. Charles from Keswick after it was taken from Dawson's Marina, or to hand the boat over somewhere in the Keswick region, or somewhere between Keswick and St. Charles. Further, it made absolutely no sense for Blair to leave the trailer in St. Charles to be returned later by Leger, if in fact he had delivered it to St. Charles as Leger stated. Being in the boat business himself, Leger had no need for such a trailer once the boat was delivered to him, since, if he were to sell the boat he could use one of his own trailers, or rent one to transport the boat to any purchaser. Further, Niagara Falls is 400 miles or so from St. Charles, and it is unlikely that Leger would drive all the way to Niagara Falls merely to return the trailer. I find that Blair meant to leave the trailer with Leger and that Blair removed the serial number in order to disguise its ownership, never expecting it to be returned to him, and never planning to return it to Fairline. I also find that Leger, knew this. Also, if Blair had driven the boat up to St. Charles on the trailer as Leger said he did, and had intended to give the trailer back to Fairline, Blair would have removed the boat and would have driven the empty trailer back with him to Niagara Falls afterwards, without having to wait until Leger returned it to him at some future time. There was no sensible reason to leave the trailer at St. Charles if it was not meant to have been included in the sale. This was a significant circumstance assisting in the resolution of the fact issues in this case.

¶ 31 On the facts as I have found them, was this sale one made in the ordinary course of business? Looking at all the circumstances, I find that it was not. I find that it was part of the ordinary business of boat dealers to sell boats to other dealers. Even though some do not, others undoubtedly do. It makes business sense, especially in remote areas to do so and I find that this is ordinarily done by boat dealers in various parts of Ontario. Thus the fact that Leger was another boat dealer would not by itself preclude him from relying on the protection of section 30, subsection 1. The benefit of this section is not for ordinary consumers only, but can also be relied upon in proper circumstances by other dealers, as the decided cases demonstrate.

¶ 32 I find also that the place where this sale was made was not the seller's usual place of business. This is not necessarily fatal to the buyer's interest. If it had been made at the boat show in Toronto, or anywhere else that business is ordinarily done by boat dealers, this would certainly have been acceptable. However this sale was concluded, I find,

either in Keswick or St. Charles, or somewhere in between, or perhaps even at the restaurant near Keswick, as Proulx indicated Leger told him on their initial meeting. None of these places are places where a seller of boats would ordinarily do business and would therefore raise suspicions which would militate against being classified as "in the ordinary course of business".

¶ 33 As for quantity, there was only one boat sold, so that there is nothing out of the ordinary about the quantity of the goods sold in this case.

¶ 34 As for the price of the boat and the trailer, I find that it was an unusually low price. It is true that Leger had agreed to purchase a similar boat for $16,000, but the Blair boat had many more options on it, which Leger well knew, and, consequently, it was worth considerably more than the one Leger had bought, which he also well knew, being a Fairline dealer himself.

¶ 35 While the 28 hours use and the few scratches may have lowered the value of the boat to a degree, it would not have lowered it by nearly over $9,000 below the actual sale price of $24,379, to take the $15,000 figure as the sale price. This is even mote significant, when the price is something less than $15,000, which I find.

¶ 36 I also find that this was not a used boat at the time of this sale to Leger, but was still a new boat and was consequently worth more.

¶ 37 Another circumstance of this case, which must be considered, is that Blair was in serious financial difficulty, having had the boat in question repossessed, and other stock as well. While he might not have told Leger about all of the details of his financial problems, he must have told him that he would give Leger a good deal because he was in some financial difficulty. Otherwise, why would he sell a boat worth $24,000 for only $15,000, or less as I have found was actually the case, and why else would Leger deal with him? Merely to save $1,000, that is to buy a similar boat that he had agreed to buy for $16,000 for $1,000 less, would not make the transaction worthwhile to Leger, given all of the risks and inconvenience involved in it. He must have known that the boat was worth considerably more than the $15,000 he says he was planning to pay, and that he would be getting it for considerably less than its market value. For such a deal, a gamble may have been worth it, but not merely to save $1,000 or so. Thus I find that even the $15,000 figure was an unreasonably low price in the circumstances, but I also find that the actual price paid was closer to $10,000, and that was clearly below the price that someone dealing in the ordinary course of business would expect to pay for such a boat.

¶ 38 Thus, considering all the circumstances here of the parties, the price paid, the place of the sale, the quantity sold, and all of the other circumstances of this sale, I find that it was not one that could be said to have been in the ordinary course of business.

¶ 39 The defendant, therefore, can not rely on section 30, subsection 1, and the plaintiff is entitled to the return of its 22-foot Holiday cabin cruiser forthwith.

¶ 40 I see no reason to interfere with the usual rule, that costs would go to the plaintiff also, especially since I disbelieved the defendant's story in large measure.

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qp/s/jjh

voked.

[9] The accused had received a notice from the Registrar on his conviction advising that his licence was revoked. Upon his appealing, he received a further notice from the Registrar that his licence was reinstated pending appeal. He learned that his appeal was dismissed. He continued to drive. He said he was awaiting further notice from the Registrar that his licence was again revoked. Such notice was only received after he had been charged with driving while his licence was revoked. Mr. Justice Ritchie, delivering the judgment of the court, said this:

> I am unable to treat the respondent's mistake otherwise than as a mistake of law in relation to his right, because of s. 250(3), to drive after his appeal had been dismissed. This was a mistake of law which does not afford the respondent a defence having regard to s. 19 of the *Criminal Code* which provides that:
>
> > '19. Ignorance of the law by a person who commits an offence is not an excuse for committing the offence.'
>
> This is no more than a codification of the common law rule and undoubtedly applies in the present case.

He added:

> It would be difficult to conceive of more clear or imperative language than that contained in s. 250(3) of the *Motor Vehicle Act* whereby the driver's licence shall be automatically 'revoked and shall remain revoked' if an appeal is 'dismissed'. The failure to appreciate the legal duty imposed by that law is of no solace to the appellant.

[10] I am of the view that the Crown's appeal must be allowed, and a conviction imposed. Pursuant to s. 613(4), this court is obliged to pass sentence. The court will accordingly hear submissions as to sentence at the next sittings of the Court of Appeal to be held at Calgary.

[11] I am authorized by the Honourable Mr. Justice McDermid to state that he concurs in this judgment.

Appeal allowed.

Editor: Eric B. Appleby
ajh

FEDERAL BUSINESS DEVELOPMENT BANK
v. STEINBOCK DEVELOPMENT CORP. LTD.
(Appeal No. 14413)

Alberta Court of Appeal
Lieberman, Moir and
Laycraft, JJ.A.
March 2, 1983.

Summary:
A bank offered a loan to Steinbock on terms. The offer was accepted. One of the terms in the offer was that the credit would lapse on November 24, 1979 unless certain documents were delivered to the bank. The documents were not delivered to the bank and the bank treated the credit as if it had lapsed. However, the bank did register securities in connection with the loan after November 24, 1979 and also attempted to collect standby fees after November 24, 1979. The bank claimed standby fees, commitment fees and legal fees of $10,313.00. Steinbock counterclaimed for damages on the basis that the bank waived the lapse date. The trial court held that the bank waived the lapse date. The judgment of the trial court is not reported in this series of reports. The bank appealed to the Alberta Court of Appeal.

The Alberta Court of Appeal allowed

the appeal and declared that the loan agreement lapsed on November 24, 1979. The Court of Appeal stated that there was no waiver because the bank did not unequivocally intend to relinquish its rights.

WAIVER - TOPIC 5
Nature of waiver - The Alberta Court of Appeal stated that waiver is essentially unilateral: it results as a legal consequence from some act or conduct of the person against whom it operates (see paragraph 15).

WAIVER - TOPIC 46
Essential elements - Intention to relinquish - The Alberta court of Appeal stated that waiver requires full knowledge of the deficiency which might be relied upon and the unequivocal intention to relinquish the right to rely on it (see paragraph 20).

CASES NOTICED:
Mitchell & Jewell Limited v. Canadian Pacific Express Company, [1974] 3 W.W.R. 259, ref'd to. [para. 19].

COUNSEL:
W.T. CORBETT, for Federal Business Development Bank;
A. JORDAN, for Steinbock Development Corporation Ltd.

This appeal was heard by LIEBERMAN, MOIR and LAYCRAFT, JJ.A., of the Alberta Court of Appeal. The judgment of the Court of Appeal was delivered by LAYCRAFT, J.A., at Calgary, Alberta, on March 2, 1983.

[1] LAYCRAFT, J.A.: The issue before the court in this case is whether a loan agreement between the parties which had lapsed or terminated in accordance with its terms on the non-performance of certain specified conditions was, nevertheless, kept in force by waiver. The trial judge found that the conduct of the bank in registering certain security documents, in collecting fees payable under the contract, and in refusing to vacate registration of the securities until fees had been paid, consti tuted a waiver of the provision for lapse.

[2] On July 25, 1979 the bank made ar offer in writing to Steinbock proposir the terms of a loan agreement for $1,696,100. The offer set forth in de tail the proposed terms of repayment including the provision of interest at 14% and complete descriptions of secur ity by way of land mortgages, chattel mortgages, guarantees and assignments by Steinbock, its associated companies and a number of its shareholders. In addition, six conditions described as "contingent conditions" were prescribe to be fulfilled by Steinbock or its as sociated companies. Other terms provided for a commitment fee of $5,000 for the payment by Steinbock of the le gal fees incurred by the bank and for standby fee commencing October 23, 19 of 3 per cent per annum payable month on the amount of the credit not drawn down from time to time. The offer als provided:

> If the credit is accepted, it will lapse on November 24, 1979 unless documentation satisfactory to the Ba has then been finished and the cred drawn upon or an extension of the lapsing date agreed upon in writing

[3] The offer was open for acceptance until August 7, 1979, a date subsequen ly extended until August 24, 1979. It was accepted within the specified time and an agreement thus came into being in the terms of the offer.

[4] The bank instructed its solicitor to commence preparation of the securit documents immediately though, of cours most conditions had not then been met This was done so that preparation of the documentation would not be respon sible for delay. Subsequently as the date for the monthly payment of stand by fees approached, an arrangement was made for an automatic monthly debit to Steinbock's account in a chartered ban in favour of The Federal Business Deve

opment bank.

[5] During the period after August 23, 1979 there were some discussions about changing the agreement. Evidence was given at trial by Steinbock and denied by the bank that some conditions to be met by Steinbock were cancelled. The amount of the loan was reduced at Steinbock's request to $847,900. The trial judge found, however, that the contract conditions were not varied but were required to be completed by November 24. The contrary was not argued on this appeal.

[6] On November 23, a number of security documents prepared by the bank's solicitors were sent to Steinbock's solicitors and were executed that day by the various company officers. Nevertheless on November 24 it is clear, on the evidence, that there were at least two deficiencies in the documentation to be provided by Steinbock and its associated companies. Audited financial statements of some of the companies had not been supplied. In addition, some company minute books were not available to Steinbock's solicitor. Therefore, instead of giving a certificate that the various corporate officers and directors had authority to perform the requisite acts and execute the required securities he was reduced to stating that his opinion, not given in any event until November 26, was

> based upon the representations of the directors of each of the aforementioned companies as some of the minute books are not in my possession.

[7] The next business day after November 24, 1979 was Monday, November 26. On that day the responsible bank officer, Mr. Flegel, spoke by telephone to the Steinbock President, Mr. Saju. He advised him at once that the loan agreement had lapsed on November 24 because of the non-fulfillment of the conditions. Subsequently Mr. Saju attended at the bank. Mr. Flegel described their conversation in his evidence at trial:

> . . . We went over the whole thing, and I talked to him about the lapsing date that for us to make any disbursements now, we would have to have that date extended, and that I would make a recommendation to head office to explain the situation why it had lapsed and to make a recommendation that we make first to have the extension of the lapsing date to approximately I think the 15th of December, and I also recommended that the interest rate not be increased.
>
> Q. Okay. Did you indicate that you were going to do that to Mr. Saju?
>
> A. Yes, I did. I made him aware at the time also of the possible chance of a rate increase, and his response there was, well, I'm getting 16 1/2 right now at the chartered bank, and I will just have to wait around to see if I can get a better rate and hoping you finance it.

[8] Mr. Saju advised Mr. Flegel that if the interest rate was increased above the 16 1/2 per cent he was paying his chartered bank, he would not accept the increase but would borrow the money from the chartered bank. The significance of this statement is that Mr. Saju recognized at this point that a new agreement would be offered and that the earlier agreement had terminated.

[9] The bank's regional office in Winnipeg ultimately authorized the extension of the lapse date on December 13, 1979 but only on condition that Steinbock agree to a new interest rate of 16 1/2 per cent. Though the new proposal did not exceed its previously stated interest limit Steinbock refused. The bank's position at this point was thus that the previous agreement had terminated, but it was willing to enter a new agreement at a higher interest rate.

[10] Meanwhile no one at the bank countermanded the instructions earlier given to the bank's solicitors to register the securities. In the next few days after November 24, all of the documents were registered against the lands and chattels to which they applied. A debenture which was part of the security was registered at the office of the Provincial Treasurer. Similarly no order was given to cancel the automatic debit of Steinbock's account at its chartered bank for the standby fees. Fees were therefore debited for the month of December, 1979 and for January, 1980, before this provision was cancelled.

[11] During the following months the bank and Steinbock disputed the payment of the legal fees incurred by the bank. Steinbock was liable for legal fees for work done by the bank's solicitors while the agreement was in force. The bank insisted, however, on the payment of all legal fees, including fees for services and disbursements in registering the securities after November 24, 1979. It took the extraordinary step of refusing to vacate the registration of the documents, which it urges had been registered by a simple error after November 24, 1979, until Steinbock paid the entire legal account. Ultimately Steinbock paid it under protest to obtain the discharge of the securities.

[12] This action was commenced by a Statement of Claim issued by the bank claiming standby fees, commitment fees and legal fees totalling $10,313.17. By the time of the trial it had agreed, however, that when the unauthorized debits from Steinbock's bank account in December, 1979 and January, 1980 were taken into account together with the legal fees, which had then been paid, the amount outstanding was $198.26.

[13] The real issue in this litigation arose from Steinbock's counterclaim in which it was alleged that the bank waived the lapse date or was estopped from asserting that the agreement had not lapsed. Consequently, it was said, the loan agreement was still in existence and had been breached by the bank's failure to advance the money. Damages were claimed, being the extra cost of higher interest paid to borrow the money.

[14] No evidence was given of representations made by the bank that the contract would be kept in existence after November 24, 1979 on which Steinbock had relied to its detriment. Estoppel was not therefore argued before the trial judge nor on this appeal. The only issue is whether the registration of the securities, the collection of the standby fees after November 24, 1979, and the collection of the legal account by the bank were a waiver of the lapse date.

[15] The trial judge, in oral reasons given from the bench found that the contract in question called for completion by November 24, 1979 failing which it would lapse. He also accepted the evidence of Mr. Flegel that he told Mr. Saju on November 26 or 27th that the contract must be treated as having lapsed on November 24. He noted that Mr. Saju had not accepted the position that the contract had lapsed. I would interject that Mr. Saju's position would not really be relevant in determining whether the contract termination date had been waived. Waiver is essentially unilateral. It results as a legal consequence from some act or conduct of the person against whom it operates. No act of the person in whose favour it operates is needed to make waiver complete.

[16] The trial judge then continued:

> Notwithstanding the position taken by it that the contract had lapsed on November 24th, 1979 the bank continued to exercise its rights under the contract. In that regard I point out that the bank registered three land mortgages on November 30th, 1979. Such mortgages were given to the bank as security with respect to the loan

in question. The bank also registered a debenture with respect to certain assets of the defendant company on December 3rd of 1979. It will be noted each of these registrations took place quite a few days after the bank had taken the position that the contract had lapsed. Having taken the steps which it did it is my view that the bank waived the requirement that the matters be concluded on or before November 24th and having done so it was not entitled to treat the matter as having lapsed without giving the plaintiff a reasonable time within which to complete the requirements that it was required to complete pursuant to the contract.

I would further point out that not only did the bank register certain of the securities given to it by the defendant, pursuant to the proposed loan but it also took advantage of the registration of such securities by refusing to release them to the defendant until such time as the defendant had paid certain obligations which the bank claimed it had under a lapsed contract, namely legal fees.

I would further point out that under the terms of the contract the bank was entitled to a stand-by fee which was to commence to run three months after the agreement for the loan had been completed with the result that such stand-by fees were to start to run on or about October 24th. The bank, however, continued to charge the stand-by fees until January 24th, 1980 being a total period of three months. If the contract had lapsed as the bank alleges it would only have been entitled to stand-by fees for a period of one month, namely until November 24th.

The charging of such stand-by fees for a period of three months is a further instance of the bank continuing to exercise its rights under the contract following the date on which it alleges it to have lapsed. In the result, therefore, the bank was not entitled to recover from the defendant the legal fees paid by it in the sum of $2,906.84. Nor was the bank entitled to the stand-by fees which it recovered from the defendant in the amount of $4,801.74 over and above the amount that it was entitled to.

[17] It is useful to examine the situation which existed on December 13, 1979 when the bank said it would extend the lapse date only on condition that Steinbock agree to a new interest rate of 16 1/2 per cent. The bank was proposing a new agreement. If Steinbock is correct that the previous agreement still existed because the bank had waived its right to insist it lapsed, then the breach of that agreement occurred on December 13. The breach would have been the refusal by the bank to honour its credit commitment. Steinbock accepted that repudiation by the bank when it went elsewhere for the money and elected to sue for damages. With repudiation on December 13 I am unable to perceive how events *after* December 13 can be considered as the waiver by the bank of the November 24 lapse date.

[18] In any event the judgment in the trial court means that the bank's conduct is held to bind it to a result opposed to its actual intention. On the overwhelming evidence and on the findings of the trial judge relating to the conversations of November 26th and 27th, the actual intention of the bank was that it did not intend to relinquish the right to rely on the lapse of the agreement. While estoppel may preclude a party from asserting or relying on its actual intention, waiver exists only as the expression of actual intention. The existence or not of waiver depends upon the determination of the intention of the person who is said to have waived the right.

[19] In *Mitchell & Jewell Limited v. Canadian Pacific Express Company*, [1974]

3 W.W.R. 259, Prowse, J.A., giving the judgment of this court, reviewed at length the authorities defining waiver. He concluded with this definition:

> Summarizing the law as set out in the above cases I am of the opinion that waiver as used in the present context arises where one party to a contract, with full knowledge that his obligation under the contract has not become operative by reason of the failure of the other party to comply with a condition of the contract, intentionally relinquishes his right to treat the contract or obligation as at an end but rather treats the contract or obligation as subsisting. It involves knowledge and consent and the acts or conduct of the person alleged to have so elected, and thereby waived that right, must be viewed objectively and must be unequivocal.

[20] The essentials of waiver are thus full knowledge of the deficiency which might be relied upon and the unequivocal intention to relinquish the right to rely on it. That intention may be expressed in a formal legal document, it may be expressed in some informal fashion or it may be inferred from conduct. In whatever fashion the intention to relinquish the right is communicated, however, the conscious intention to do so is what must be ascertained.

[21] In this case the bank officer did not express an intention to relinquish the bank's right to insist on the lapse date. On the contrary on the first business day after the lapse he stated the bank's intention to rely on it and further re-iterated that intention in the personal interview with Mr. Saju. He said he would try to get an extension but it might possibly be at a higher interest rate. He would, in effect, try to get approval for a new contract. The failure to stop registration of the documents and the failure to terminate the automatic debit of Steinbock's bank account was inadvertent or even negligent. It may well have been the foundation of a claim for damages. In the face of the positive assertion that the bank would rely on the lapse, however, those acts cannot in my respectful opinion found an inference of the bank's intention to do the contrary.

[22] The further act of refusing to discharge the registration of the securities is, in my opinion, not referrable to the loan agreement at all. One is tempted to use somewhat violent language in characterizing that act. I will content myself with observing that it was wrongful but again I cannot conclude that it demonstrates the bank's intention to continue the contract in existence even if it had happened prior to December 13. On the contrary, the premise underlying discharge of the securities is that the contract is at an end. That is so even though the bank sought to exact a price for remedying the earlier negligent registration of the documents.

[23] The existence of waiver requires a finding of knowledge and intention. It is therefore a finding of fact. In my view, however, the facts on this record and those found by the trial judge are not capable of constituting a waiver. I would accordingly allow the appeal and declare that the loan agreement between the parties came to an end on November 24, 1979 and that the appellant The Federal Business Development Bank was not in default of its obligations under that agreement.

[24] The accounts between the parties which had accrued at the time the agreement terminated and which resulted from the events subsequent to the termination, remain to be settled. Steinbock was liable for the commitment fee of $5,000. It was also liable for the standby fee for one month of $2,161.38. The legal fees present more of a problem. Some legal fees were incurred in the preparation of the documents during the currency of the agreement. Some of them were, however, disbursements and services done in the registration of the

documents after its termination. During the course of the argument of this appeal, the court pointed out that the account for legal fees did not specify which services were done before November 24 and which were done after. If the contract did not exist after November 24, there could be no right under it for reimbursement of legal fees incurred after November 24. Counsel thereupon abandoned the bank's claim to legal fees.

[25] The account between the parties is therefore as follows:

Paid by Steinbock		
Legal Fees	$2,906.84	
Standby Fees debited	$6,963.12	
		$9,869.96
Payable by Steinbock		
Standby fees - one month	$2,161.38	
Commitment Fee	$5,000.00	$7,161.38
Due to Steinbock		$2,708.58

[26] The judgment below is therefore varied to provide that the action of The Federal Business Development bank be dismissed and that Steinbock have judgment on its counterclaim against the bank for $2,708.58. All other claims for relief in the counterclaim are dismissed.

[27] In view of the course which this litigation has taken I would award Steinbock the costs of the trial in both the action and the counterclaim to be taxed under column 5 of The Consolidated Rules of Court, limiting rules not to apply. Since the bank has had the substantial success on this appeal I would award it costs of the appeal on the same column.

Appeal allowed.

Editor: Eric B. Appleby
ajh

R. v. FOREMOST TRANSPORT PERSONNEL AND MANAGEMENT SERVICES LTD. and ATTORNEY GENERAL OF ALBERTA (intervenor)
(Appeal No. 15392)

Alberta Court of Appeal
McDermid, Belzil and Stevenson, JJ.A.
December 3, 1982.

Summary:

Foremost Transport was charged with contravening the Alberta Labour Act. The charge was dismissed on the ground that the Alberta Labour Act did not apply to Foremost because it was involved in interprovincial trucking. The Crown appealed to the Alberta Court of Queen's Bench.

The Alberta Court of Queen's Bench dismissed the Appeal. The judgment of the Court of Queen's Bench is not reported in this series of reports. The Crown appealed to the Alberta Court of Appeal.

The Alberta Court of Appeal dismissed the Appeal.

CONSTITUTIONAL LAW - TOPIC 6642

Federal jurisdiction - Interprovincial works - Transportation - An independently owned trucking company contracted with Simpsons-Sears Ltd. for the transportation of the retailer's goods within Alberta and out of Alberta - The Alberta Court of Appeal held that the trucking company was a federal or interprovincial undertaking and was not subject to the Alberta Labour Act.

CONSTITUTIONAL LAW - TOPIC 6641

Federal jurisdiction - Interprovincial works and undertakings - The Alberta Court of Appeal stated that once it is decided that as a matter of law that an activity can be found to be federal, then it is a question of fact whether it is federal (see paragraph 6).

14 C.B.R. 460, (sub nom. Commercial Finance Corp. v. Martin) [1933] S.C.R.

591, [1933] 4 D.L.R. 375

1933 CarswellOnt 49

Grand River Motors Ltd. (Trustee of) v. Commercial Finance Corp.

In re Grand River Motors Limited

Trustee v. Commercial Finance Corporation Limited

Supreme Court of Canada

Rinfret, Lamont, Smith, Cannon and Hughes, JJ.

Judgment: June 28, 1933

Counsel: J. C. McRuer, K.C., and F. A. Brewin, for Commercial Finance Corporation Limited, appellant.

J. M. Bullen, and Lionel Davis, for the trustee, respondent.

Subject: Corporate and Commercial; Property; Contracts; Insolvency

Chattel Mortgages and Bills of Sale --- Property covered by act -- After- acquired property.

Chattel Mortgages and Bills of Sale --- Transactions covered by Act -- Agreement operating as chattel mortgage -- Purported conditional sales contract.

Sale of Goods --- Transfer of property.

Bankruptcy --- Avoidance of transactions prior to bankruptcy.

Conditional Sale -- Bills of Sale of Cars by Debtor to Discount Company Followed by Conditional Sale Agreements by

Latter to Debtor -- Bills of Sale Not Registered -- Course of Business -- Possession of Cars Taken by Discount Company after Bankruptcy -- Claim by Trustee to Proceeds of Sales -- Trial of Issue -- Real Object of Transactions -- Loan by Discount Company to Debtor -- Whether Estoppel as against Trustee -- Judgment in Trustee's Favour -- Dismissal of Appeal -- Further Appeal -- Whether Debtor Held Cars in Trust for Discount Company -- Dismissal of Appeal -- The Bills of Sale and Chattel Mortgage Act, R.S.O., 1927, Ch. 164, Secs. 8, 14.

An appeal by Commercial Finance Corporation Limited from the judgment of the Court of Appeal for Ontario (Latchford, C.J., Magee, Hodgins, Fisher and Grant, JJ.A.), 14 C.B.R. 165, [1932] O.R. 712, dismissing an appeal from the judgment of Sedgewick, J., 13 C.B.R. 107, [1932] O.R. 101, where the facts are stated in the headnotes, was dismissed with costs.

In order to overcome the difficulties presented by secs. 8 and 14 of The Bills of Sale and Chattel Mortgage Act, it was contended on behalf of the appellant that a trust was created by which the debtor held the cars in trust for the appellant, to which The Bills of Sale and Chattel Mortgage Act did not apply, and it was argued that, in view of the general course of dealings between the debtor and the appellant in connection with the financing of the purchase of the cars by the debtor, it should be held that such a trust was created. It was also contended that the respondent was estopped by his own conduct from recovering the amount claimed.

Held, as to the Viking cars, that there was a sale, or an attempted sale, of goods and chattels which were not the property of or in the possession, custody or control of the bargainor, or any person on his behalf, at the time of the making of the sale and it came within sec. 14 of The Bills of Sale and Chattel Mortgage Act, and the transfer not being filed or registered pursuant to the Act, was by virtue of the Act, void as against creditors of the transferor.

Held, further, as to the cars purchased from the General Motors of Canada, Limited, that the title to these cars vested in the debtor upon delivery, and the bill of sale of these cars to the appellant, without change of possession, and without registration, was a document within the provisions of sec. 8 of The Bills of Sale and Chattel Mortgage Act, and void as against creditors of the debtor.

Held, further, as to the creation of a trust in favour of the appellant the argument was untenable in that the argument of the appellant must be that the provision of the Act that made the appellant's title void had, at the same time, the effect of vesting or retaining the legal ownership in the debtor as trustee, with a valid equitable ownership in the appellant, and to hold that a trust in favour of the appellant was thus created, unaffected by the provisions of the Act, would render the Act of no effect.

Held, further, that under the circumstances the trustee was not estopped from recovering the amount claimed.

The appeal was dismissed with costs.

Smith J. (concurred in by Rinfret and Hughes, JJ.):

1 Grand River Motors Limited, the debtor, carried on business in Galt and Hamilton as automobile dealers, and, in the course of their business, ordered and received the following automobiles, of the values set out:

La Salle Coupe, Serial No. 413537 ..... $2,789.50

Viking Sedan, Serial No. V.D.S. 979 ..... 1,900.00

Oldsmobile Coupe, Serial No. 27311 ..... 780.43

Viking Sedan, Serial No. V.B. 353 ..... 1,800.00

Oldsmobile Coupe, Serial No. 27529 ..... 708.27

Oldsmobile Coach, Serial No. 27588 ..... 793.92

Oldsmobile Coach, Serial No. 27456 ..... 715.00

$9,487.12

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2 These automobiles were in stock in the debtor's premises at the time of the assignment.

3 The two Viking automobiles were ordered from the makers in the United States, and were shipped to the debtor by freight, and the bill of lading was sent to a bank with a draft for the price attached, so that the debtor was able to get possession by payment of the draft. The debtor ascertained from the bill of lading at the bank the serial numbers of the cars, and then went to the appellant company, and executed an "indenture" in form Exhibit 2 (b), in reality a bill of sale, purporting to sell, assign, transfer and set over to the appellant company these automobiles described by their serial numbers, in consideration of the price represented by the drafts. These bills of sale were not filed, as provided by *The Bills of Sale and Chattel Mortgage Act*, R.S.O., 1927, ch. 164.

4 The appellant and the debtor then executed a conditional sale agreement, by which the appellant agreed to sell the automobiles to the debtor for the amounts represented by the drafts, this purchase price to be paid by the debtor to the appellant at stated times, the property in the automobiles to remain in the appellant until the price should be paid.

5 On completion of these documents, cheques for the amount of the drafts payable to the bank were given the debtor, with which the debtor paid the drafts and got possession of the bills of lading, and the cars.

6 These facts place the transaction in connection with the two Viking cars practically on all fours with the facts in *In re Smith & Hogan Ltd.; Industrial Acceptance Corpn. v. Can. Permanent Trust Co.*, 14 C.B.R. 20, [1932] S.C.R. 661. The statutes having a bearing in that case were *The Bills of Sale Act*, R.S.N.B, 1927, ch. 151, and *The Conditional Sales Act*, R.S.N.B., 1927, ch. 152. The gist of the decision in that case was that the vendor in the conditional sale agreement had acquired the legal title and ownership of the cars at the time the conditional sale agreement was made, and that this legal ownership had never passed to or become vested in the dealer, who was the purchaser under the conditional sale agreement. In both cases the cars were ordered by the dealer, were shipped to the dealer, and bills of lading sent with sight draft attached. The legal ownership, therefore, was retained by the shipper, and the dealer's only right at that stage was a right to obtain legal ownership by payment of the draft.

7 In the *Smith & Hogan, Case* it was held that, by virtue of the various documents and the payment of the draft, the legal title and ownership, on payment of the draft, passed to the vendor in the conditional sale agreement, and not to the dealer, who was the vendee in that agreement.

8 Here, also, the dealer -- that is, the debtor -- obtained no legal title or ownership to the cars by virtue of the shipment and the sending of the bills of lading with sight draft attached; the title, at that stage, being still in the shipper. The "indentures" or bills of sale from the debtor to the appellant did not pass the legal title to the appellant, because the title or ownership still remained in the shipper, and could not be transferred to the appellant until the drafts were paid. Ownership, however, would, as between the two parties, pass to the appellant on payment of the draft, which would give the appellant complete title and ownership of the cars, unless *The Bills of Sale and Chattel Mortgage Act* of Ontario, R.S.O., 1927, ch. 164, makes a transfer of legal ownership by that method void as against the creditors.

9 In the *Smith and Hogan Case* it was held that *The Bills of Sale Act* of New Brunswick, sec. 6, has to do with a transfer or sale of chattels where the transferor or seller has the ownership of the chattels at the time of transfer or sale, and does not apply to a transfer of a mere right to acquire ownership of chattels.

10 This principle seems to have been well established by Ontario decisions under sec. 8 of the Ontario statute.

11 In *Burton v. Bellhouse* (1860), 20 U.C.Q.B. 60, it was held that a verbal agreement to buy from a manufacturer two half-finished locomotives, to be finished, passed the property, and that *The Chattel Mortgage Act* did not apply.

12 In *Coyne v. Lee* (1887), 14 O.A.R. 503, it was held that a chattel mortgage of goods to be acquired by the mortgagor was good as against creditors, on the ground that the mortgagee acquired an equitable title, which became a legal title as soon as the goods were acquired.

13 In *Horsfall v. Boisseau* (1894), 21 0.A.R. 663, Hagarty, C.J.O., at p. 665, says:

> Before the passing of the Act of 1892, there does not appear to have been any statutable provision respecting future goods brought into a stock in trade on which a chattel mortgage was given.

14 In *Banks v. Robinson* (1888), 15 O.R. 618, Boyd, C., at p. 622, says:

> My opinion is, that the Bills of Sale and Chattel Mortgages Act, R.S.O. ch. 125, 1887, was not intended to cover agreements creating equitable interests in non-existing and future-acquired property. The Act relates to existing chattels capable of manual delivery and susceptible of full and certain description for the purpose of identification, at the date of the instrument.

15 Many other cases to the same effect might be cited. Here the goods were in existence, and fully identified, but, as already stated, the debtor had not the property in them, and they were not capable of delivery by the debtor at the date of the instrument; and a mere equitable title was transferred at that stage, capable of being converted into a full legal title by acceptance and payment of the draft.

16 R.S.O., 1927, ch. 164, sec. 8, is the same as sec. 6 of the New Brunswick statute and, if it stood alone, I am unable to see any distinction between the *Smith and Hogan Case* and this one, as far as these Viking cars are concerned. The "indenture," or bill of sale, in this case could not transfer the property and ownership in the cars to the appellant, because the debtor did not have such property and ownership, and surely could not transfer a property that it did not own, but which was still owned by the shipper. All that the debtor had when this "indenture" was executed was a right to acquire the ownership by payment of the draft, and this right or interest in the property was all that passed by virtue of the "indenture."

17 Sec. 8 referred to, like sec. 6 of the New Brunswick Act, deals only with a sale of chattels, which means a transfer of the ownership. On this principle it was held in the Ontario courts that the provisions of sec. 8 did not apply to property to be acquired by the vendor in future, or not capable of immediate delivery. The scope of sec. 8 in the original Act was enlarged, in 1892, by 55 Vict., ch. 26, sec. 1, which is now sec. 14, and reads as follows:

> This Act shall extend to a mortgage or sale of goods and chattels which may not be the property of or in the possession, custody or control of the mortgagor or bargainor, or any person on his behalf at the time of the making of the mortgage or sale, and notwithstanding that such goods or chattels may be intended to be delivered at some future time, or that the same may not at the time of the making of the mortgage or sale be actually procured or provided or fit or ready for delivery, or that some act may be required for the making or completing of such goods and chattels, or rendering the same fit for delivery.

18 This section seems to cover precisely the attempted transfer of the ownership in these Viking cars by means of the "indenture," or bill of sale, and payment of the drafts by the appellant. It was a sale, or attempted sale, of goods and chattels which were not the property of or in the possession, custody or control of the bargainor, or any person on his behalf, at the time of the making of the sale, which comes within the precise words of this section of the statute. That

transfer, not having been filed or registered pursuant to the Act, becomes, by virtue of the Act, void as against creditors of the transferor. The language of the section is, no doubt, open to criticism, because it is difficult to understand how one is able to sell goods and chattels that are not his property, though there can be no doubt of his ability to transfer an interest which he may have in goods and chattels that he does not own. This section, however, in terms extends to any instrument that purports to sell goods of which the vendor is not the owner, and therefore extends to any interest in chattels transferred by such instrument.

19 Mr. McRuer realized that this section in the Ontario statute distinguishes the present case from the caseof *Smith and Hogan Ltd.*, and sought, in a very able argument, to overcome this difficulty upon the theory that a trust was created by which the debtor held these cars in trust for the appellant, to which *The Bills of Sale and Chattel Mortgage Act* does not apply. Before dealing with this contention, I shall refer to the remaining cars in dispute, which were dealt with in an entirely different manner.

20 These were all purchased from the General Motors of Canada, Limited. When the debtor was ordering one of these cars, it would send its driver to the factory of the General Motors with a blank cheque of the debtor, which would be filled in for the price of the car to be taken over, and would be handed to the General Motors Limited. The driver would then take possession of the car, and drive it to the place of business of the debtor, where it would be taken into stock. The debtor would then execute an "indenture," or bill of sale of the car to the appellant, who would then execute a conditional sale of it to the debtor for the original price, or ninety per cent. of it, and the debtor would receive appellant's cheque, payable to the debtor, for the purchase price stated in the conditional sale agreement. The debtor would then deposit this cheque to its credit in the bank, which would provide the funds required to meet the cheque given to the General Motors, if no funds, or no sufficient funds, were otherwise on hand to meet such cheque.

21 It seems to me impossible to argue that the ownership and property in these cars, purchased from the General Motors Limited, did not vest in the debtor upon delivery. The "indenture" or bill of sale of these cars to the appellant, without change of possession, and without registration, is a document coming precisely within the provisions of sec. 8 of the Act, and void as against creditors of the debtor. As against creditors, therefore, the appellant acquired no title or ownership by virtue of the bills of sale, and therefore, as against creditors, was not in a position to make a conditional sale of the cars to the debtor, retaining the ownership. because, as against the creditors, that ownership never passed to the appellant.

22 This difficulty, again, is sought to be avoided upon the theory of a trust having been created by the act and intention of the parties. It is argued that, in view of the general course of dealings between the debtor and the appellant in connection with the financing of the purchase of these cars by the debtor, it should be held that such a trust was created. As between themselves, there was no occasion for the creation of any trust, because, as against the debtor, the appellant obtained complete title and ownership to these automobiles, and the conditional sale agreement was perfectly valid. In order to hold that the debtor was a trustee for the appellant, it must be determined that the legal title and ownership was vested in the debtor and the beneficial interest in the appellant. The very reverse was, however, the real situation, the appellant's difficulty being that its legal ownership, by virtue of the Act, was void as against creditors.

23 The argument of the appellant must be that the provision of the Act that makes the appellant's title void has, at the same time, the effect of vesting or retaining the legal ownership in the debtor as trustee, with a valid equitable ownership in the appellant. To hold that a trust in favour of the appellant was thus created, unaffected by the provisions of the statute, would virtually render the statute of no effect. This argument seems to me untenable.

24 It was also contended that the respondent was estopped by his own conduct frown recovering the amount claimed. The appellant demanded from him, and obtained, possession of the cars, which the appellant sold; and it is argued that this giving up of possession by the trustee amounts either to an actual abandonment of the property by the trustee or is in the nature of an estoppel against the trustee. The learned trial judge, (1931), 13 C.B.R. 107, at p. 110, holds that the trustee did not agree with the appellant that the appellant was entitled to possession of the cars by virtue of its securities, but intimated, in giving up possession, that the question of appellant's title was not admitted, and was being investigated by its solicitors. He further points out that the trustee cannot, without the authority of the inspectors, give up any right which the trustee has in respect of the debtor's property, and that therefore no act of the trustee, unauthorized by the inspectors, can raise an estoppel against the trustee.

25 I agree with the finding of the trial judge that there was no estoppel under the circumstances.

26 The appeal must be dismissed with costs.

Lamont, J.:

27 In this case I concur in the conclusion reached by my brother Smith. In so far as the automobiles purchased from the General Motors are concerned I concur for the reason stated in my brother's judgment. In so far as the two Viking cars are concerned I concur for the reason that the evidence, in my opinion, clearly establishes an intention on the part of both the dealer (the Grand River Motors, Limited) and the Commercial Finance Corporation that the dealer should acquire title to the cars from the shipper and then, having the property in them it itself, should sell them to the corporation. The corporation, it was understood, would in turn sell them back to the dealer under a conditional sales agreement. That such was the mutual intention is made clear by a perusal of the documents and an examination of the course of dealing between the parties.

28 When the cars arrived from the shipper, and the dealer was notified that the bill of lading with a draft attached for the price was at the bank, the dealer inspected the cars and ascertained the descriptive number and model of each. These numbers it took to the corporation, got the corporation's cheque for the price and gave the corporation a bill of sale of the cars, which were still in the possession of the railway company, and which were to be delivered to the dealer on payment of the draft. The cheque of the corporation paid the draft; the cars were handed over to the dealer, and were placed in the dealer's warehouse. That the dealer was to acquire the property in the cars before selling them is shown by the bill of sale (designated an "indenture"), given by the dealer and accepted by the corporation. In that document the dealer is described as "vendor" and the corporation as "purchaser." The document contains the following:

Witnesseth that, in consideration of the said total selling price of lawful money of Canada paid by the purchaser to the vendor (the receipt whereof is by him acknowledged) the vendor hath sold, assigned, transferred and set over and doth hereby sell, assign, transfer and set over unto the purchaser, its successors and assigns, the motor vehicles of the respective numbers, makes and models and for the respective prices shewn on the margin hereof, which said motor vehicles are contained in, upon or about the premises of the vendor, situate and being at No. 70 John Street North, in the City of Hamilton, and County of Wentworth.

The vendor hereby represents and warrants to the purchaser that the said motor vehicles are brand new, and covenants that he, the vendor, is rightfully and absolutely possessed of and entitled to the said motor vehicles and rightfully entitled to sell the same to the purchaser, and that the latter has, by virtue hereof, become the rightful owner thereof by a good and sufficient title free and clear of all liens, charges and encumbrances whatsoever.

29 By this document the parties in the clearest and most explicit language have declared:

30 1. That the dealer was selling to the corporation the cars described in the document.

31 2. That the dealer was rightfully and absolutely possessed of the cars.

32 3. That it was entitled to sell them to the corporation, and

33 4. That the corporation, by virtue of this bill of sale, had become the rightful owner of the cars.

34 I do not think language more definite or explicit could be used to convey the idea that the dealer was selling to the corporation and the corporation was purchasing cars of which the dealer was the owner and of which it had absolute property.

35 It was, however, argued that at the moment the bill of sale was signed the dealer did not have title to the cars, that the title was then in the shipper and, therefore, the dealer could not pass to the corporation property in the cars which he did not possess. The answer to this argument, in my opinion, is that the bill of sale was executed at that particular time for

the convenience of the dealer in the ordinary course of business and to avoid the necessity of returning to execute it after he had paid the shipper's draft. It was, however, not intended to operate as a bill of sale until the dealer had the cars upon its premises, where he could not have them until after the draft was paid. This is shown by the language used in the first of the above quoted paragraphs in which it is declared that the cars being sold

> are contained in, upon or about the premises of the Vendor, situate and being at No. 70 John Street North, in the City of Hamilton,

and also by the declaration that the dealer was selling its own cars. What took place in this case was just an ordinary, everyday transaction in which the conveyance was drawn up and executed preparatory to the completion of the transaction. I cannot think that the legal effect of such a transaction can be made to depend upon whether the dealer executes the bill of sale before he pays the shipper's draft and receives the bill of lading, or afterwards. The order in which the various steps toward completion are taken is immaterial, the documents are effective from the moment the parties intended they should become operative.

36 The appellant strongly relied upon the judgment of this Court in *In re Smith and Hogan, Ltd.; Industrial Acceptance Acceptance Corpn. v. Can. Permanent Trust Co.* , 14 C.B.R. 20, [1932] S.C.R. 661. In my opinion that case has no application to the one before us. In the *Smith and Hogan* Case, which in some respects resembles the present one, there was no bill of sale from the dealer to the financial company which was supplying the dealer with money to carry on its business. There was, in that case, nothing to indicate the real nature of the transaction except the cheques representing the moneys advanced, the conditional sales agreement from the financial company to the dealer, and the course of business between the parties. There was no evidence, verbal or written, that the dealer had ever agreed to sell to the financial company, or that the company had agreed to purchase the automobiles described in the con ditional sales agreement. The intention of the parties, therefore, had to be inferred from the conditional sales agreement and the course of dealing between the parties. This Court, by a majority, drew the inference (p. 30, p. 668, S.C.R.):

> that both parties intended that the cheque was given on the condition that title was to pass to appellants, and it could only be so passed by use, on appellant's behalf, of Smith & Hogan's right to acquire ownership and possession,

and

> that an agreement was arrived at ... (p. 669) by which Smith & Hogan, Limited, in consideration of the cheques, tranferred to the appellant their right to acquire ownership and possession of the cars.

37 The ratio of that decision, therefore, was that both parties understood and intended that what the company was to obtain for its cheque was a transfer of the dealer's right to acquire ownership and possession of the cars, and not the cars themselves. In other words the company was to receive what, in effect, would be an assignment of the dealer's rights under its contract to purchase.

38 As I have said, that case, in my opinion, can have no application here, for, in the case before us, it seems to me impossible for a court without doing violence to the language used in the bill of sale, to find as a fact that the intention of the parties was that the Commercial Finance Corporation, in consideration of the cheques which it advanced, was to have only an equitable right to acquire the ownership and possession of the cars, and not the property in the cars themselves. The question involved, in my opinion, is one of fact.

39 CANNON, J. also agreed that the appeal should be dismissed with costs.

END OF DOCUMENT

Robert M. Hall
Justice

SUMMARY OF CURRENT DOCUMENT	
Name of Issuing Party or Person:	**Hall, J.**
Date of Document:	**2003 01 03**
Summary of Order/Relief Sought or statement of purpose in filing:	**Decision in Interlocutory Application by Wells Fargo Equipment Finance Company seeking recovery of equipment in the possession of the court appointed Receiver of Hickman Equipment (1985) Limited**
Court Sub-File Number:	**7:05**

DATE: 2003 01 03
DOCKET: 2002 01 T 0352

IN THE SUPREME COURT OF NEWFOUNDLAND AND LABRADOR
TRIAL DIVISION

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

AND IN THE MATTER OF the Application of Wells Fargo Equipment Finance Company for possession of two pieces of equipment in the possession of Hickman Equipment (1985) Limited

Heard June 5 and 6, July 5, September 9, 10 and 11, 2002

DECISION OF HALL, J.

Background

[1] By an Originating Application (*Ex Parte*) filed February 7, 2002 Hickman Equipment (1985) Limited ("HEL") applied for relief under the **Companies' Creditors Arrangement Act**, R.S.C. 1985 c. C-36 (the "**CCAA**"), and an order issued on that

date granted the relief applied for by HEL including an order staying proceedings against HEL. By March 13, 2002 it became apparent that HEL would not be able to formulate a scheme of arrangement under the **CCAA** which would be acceptable to its creditors and upon the application of Wells Fargo Equipment Finance Company ("Wells Fargo") and HEL, the application pursuant to the **CCAA** was terminated and PricewaterhouseCoopers Inc. was appointed Receiver of all of the property assets and entitlements of HEL and Trustee of HEL pursuant to the **Bankruptcy and Insolvency Act**, R.S.C. 1985 c. B-3 (the "**BIA**").

[2] Prior to the receivership and bankruptcy of HEL, Wells Fargo had made application to the Court requiring HEL to deliver up possession to Wells Fargo of two pieces of equipment described in the application which were claimed by Wells Fargo as being its property. Wells Fargo had submitted that it was the owner of the two pieces of equipment (the "Equipment") pursuant to two Equipment Leases dated July 6, 1999 and November 10, 1999 wherein Wells Fargo leased the Equipment to HEL for use by HEL in its business of short term rental of construction equipment. It was submitted by Wells Fargo, and not disputed by opposing creditors, that the Equipment Leases were duly executed and registered in the Registry of Bills of Sales, Conditional Sales and Chattel Mortgages, and thus constituted "prior security interest(s)" pursuant to s. 2(ee) of the **Personal Property Security Act**, R.S.N. 1998 c. P-7.1, as amended (the "**PPSA**"). Notwithstanding compliance with the requirements for registration and execution under the prior law, the validity of the Wells Fargo Equipment Leases as security under the prior law was challenged by opposing creditors on the basis that the Equipment had been part of the inventory of HEL, had not left HEL's possession at the time of the Equipment Leases, had not come into the possession of Wells Fargo and, because no bills of sale absolute were registered, the sales (and Equipment Leases) made by HEL were void as against creditors and as against subsequent purchasers or mortgagees claiming from or under HEL in good faith or valuable consideration without notice whose conveyance or mortgage had been registered or was valid without registration, as stipulated by s. 5(1) of the **Bills of Sale Act**, R.S.N. 1990 c. B-3. This issue is dealt with later in this judgment.

[3] The Receivership Order filed March 14, 2002 directed PricewaterhouseCoopers Inc. as Receiver to develop and recommend an optimal method for disposition of the assets of HEL and the distribution of its property or proceeds to those claimants or creditors entitled thereto, with a recommended procedure to dispose of all realizable assets, including the allocation of the costs of the entire process (the "Realization

Plan"). In addition the Receivership Order directed the Receiver to conduct such investigations and analyses of the assets of HEL as may in its judgment be necessary or advisable to enable it to develop a plan for the determination of the rights and entitlement of creditors to the assets, including the allocation of the costs of the entire process (the "Claims Plan").

[4] The Receivership Order also contained the usual clauses prohibiting the commencement or continuation of any proceedings against HEL without the written consent of the Receiver or the approval of the Court. There was no specific provision in the Receivership Order dealing precisely with the status of the Wells Fargo application for the return of equipment which it claimed as its property, which application had been made prior to the issuance of the Receivership Order. This became a bone of contention between the various creditors who claimed competing interests to those of Wells Fargo in respect of the Equipment. Counsel for the Trustee and the Receiver both acknowledged that they had represented to counsel for Wells Fargo that the issuance of the Receiving Order and the Receivership Order were without prejudice to the right of Wells Fargo to continue its application for the return of the Equipment notwithstanding those two Orders having been issued. Ultimately it became clear that rather than being simply an application for repossession of its own property, Wells Fargo considered its application as one which would determine the respective priorities of the various creditors claiming an interest in the Equipment. The creditors in opposition to Wells Fargo took the position that the determination of priorities was the very purpose behind the Claims Plan portion of the Receivership Order and that by continuing its application with a view to determining priorities between secured creditors as opposed to merely determining "ownership", Wells Fargo was attempting to jump the queue amongst the creditors and have its claim (including priority issues) tried in priority to other creditors.

[5] As a result of this confusion, it was ordered that the next hearings with respect to the Wells Fargo application would be confined to the following three preliminary points of law:

(a) Had Wells Fargo established that the security agreements upon which it relied for its security interest in the Equipment are valid?

(b) Did Wells Fargo properly register its security agreements pre-**PPSA** so as to protect its security interest in the Equipment from the claims of other creditors and buyers in the ordinary course of business? and

(c) Did Wells Fargo properly comply with the transition provisions of the **PPSA** in respect of the security agreements upon which it relied for its security interest in the Equipment, and if not, what would be the effect of the failure by Wells Fargo to comply with the transitional provisions of the **PPSA**?

[6] It was the intention of this Order that if Wells Fargo could not establish an absolute priority to the Equipment be reason of being the first properly registered and continued security holder thereto, Wells Fargo's priority interest thereto should properly be determined under the provisions of the Claims Plan and if Wells Fargo disputed such priority conclusion of the Receiver, a hearing with respect to that issue would determine the priority after the results of the Claims Plan had been filed. It was on this basis that the application of Wells Fargo continued. During the course of argument by Wells Fargo, issues other than those covered by the three preliminary questions of law arose in the argument of counsel for Wells Fargo. Principal amongst these was the argument that Wells Fargo could be subrogated to the security interests of John Deere Limited and that if the Wells Fargo security failed to be first registered, perfected and continued security as against the Equipment, Wells Fargo fell into the shoes of John Deere Limited and was entitled to Deere's priority position vis-a-vis the Equipment. Notwithstanding the intention to limit the hearing to the three questions set out in paragraph [5] hereof, argument on this further point was heard. However, I reserved the right to allow other creditors, who claimed to have been prejudiced by this argument being pursued in light of the limitation of the hearing to the aforementioned three preliminary questions of law, to present further evidence and argument on these issues in the event that I were to find that the Wells Fargo security, in its own right, did not grant a first security position with respect to the Equipment.

Question 1: **HAS WELLS FARGO ESTABLISHED THAT THE SECURITY AGREEMENTS UPON WHICH IT RELIES FOR ITS SECURITY INTEREST IN THE EQUIPMENT ARE VALID?**

[7] There was no serious suggestion that the pre-**PPSA** security documents executed by HEL in favour of Wells Fargo were of themselves invalid or improperly executed under the prior law.

Question 2: **DID WELLS FARGO PROPERLY REGISTER ITS SECURITY AGREEMENTS PRE-PPSA SO AS TO PROTECT ITS SECURITY INTEREST IN THE EQUIPMENT FROM THE CLAIMS OF OTHER CREDITORS AND BUYERS IN THE ORDINARY COURSE OF BUSINESS?**

[8] The Equipment which is the subject of this application was in the possession of HEL pursuant to a John Deere Industrial Dealer Agreement dated March 8, 1995 and made between HEL and John Deere Limited (the "Dealer Agreement"). The Equipment was supplied to HEL as Consigned Goods pursuant to the Dealer Agreement and HEL had specific authority under the Dealer Agreement to sell the Equipment which was owned by John Deere Limited. HEL purported to sell the Equipment which is the subject of this present application to Wells Fargo by two bills of sale absolute dated July 6, 1999 and November 10, 1999 (collectively, the "Bills of Sale"). On the same dates HEL entered into Equipment Leases with Wells Fargo which Equipment Leases were registered in the Registry of Bills of Sale, Conditional Sales and Chattel Mortgages in the appropriate manner. If there was no legal requirement to register the Bills of Sale, I am satisfied that the execution of the Equipment Leases and their registration was such as to perfect the security interest of Wells Fargo in the Equipment pursuant to the **Conditional Sales Act**, R.S.N. 1990 c. C-28. Because the Equipment Leases arose prior to the coming into force of the **PPSA**, under s. 74(4) of the **PPSA**, the validity of these prior security interests is governed by prior law. However, Wells Fargo made no registration of the Bills of Sale under the **Bills of Sale Act**, R.S.N. 1990 c. B-3, as amended. As previously summarized in paragraph [2] of this judgment, s. 5(1) of the **Bills of Sale Act** provides:

"A sale or mortgage that is not accompanied by immediate delivery and an actual and continued change of possession of the chattels sold or mortgaged is, unless the sale or mortgage is evidenced by a registered bill of sale, void as against a creditor and as against a subsequent purchaser or mortgagee claiming from or under the grantor in good faith for valuable consideration without notice whose conveyance or mortgage has been registered or is valid without registration."

[9] Registration of the Bills of Sale (absolute), as required by s. 5(1) of the **Bills of Sale Act,** would have been effected, if it had in fact occurred, in the self same Registry of Bills of Sale, Conditional Sales and Chattel Mortgages as was registration of the Equipment Leases. Under the procedures established by that Registry, the Bills of Sale would have been registered without any registration detail distinguishing them from bills of sale which constituted chattel mortgages. Therefore any party searching in this Registry for encumbrances against the assets of HEL, would have discovered the registered Equipment Leases and would have been able to deduce therefrom that title or ownership of the Equipment was claimed by Wells Fargo, even though no registered bill of sale absolute appeared in that Registry.

[10] The creditors in opposition to Wells Fargo state that:

(a) A "sale" under the **Bills of Sale Act** is stated to include "a sale, assignment, transfer, conveyance, declaration of trust without transfer, or other assurance of chattels **not intended to operate as a mortgage**, or an agreement, whether or not intended to be followed by the execution of another instrument, by which a right in equity to chattels is conferred, but does not include ... (ii) a transfer or sale of goods in the ordinary course of a trade or calling (s. 2(0)).

(b) A "mortgage" under the **Bills of Sale Act** is stated to include "an assignment, transfer, conveyance, declaration of trust without transfer, or other assurance of chattels, **intended to operate as a mortgage or pledge**, or a power or authority or licence to take possession of chattels as security, or an agreement, whether or not intended to be followed by the execution of another instrument, by which a right in equity to a charge on chattels is conferred ..." (s. 2(j)).

[11] The creditors in opposition to Wells Fargo contend that there was no actual or continued change in possession of the Equipment and that Wells Fargo provided no

evidence that it ever took possession thereof and argue that in fact, if Wells Fargo had taken possession of the Equipment, this would have been contrary to the intent of the sales/lease back agreement whereby Wells Fargo would finance the Equipment and HEL would maintain possession.

[12] Wells Fargo on the other hand contends that if there was a sale from HEL to Wells Fargo it was not a sale to which the **Bills of Sale Act** applied. Wells Fargo contends that the transaction was, in substance, a hirer-purchase transaction and not a loan secured by mortgage. They contend that the sale was real, in the ordinary course of business of HEL and for a legitimate set of business and legal purposes, namely, the creation of an addition to the rental equipment fleet of HEL and, particularly, the obtaining by Wells Fargo of the substantial tax benefits by way of capital cost allowance which it became entitled to and did in fact deduct as the owner of the Equipment. The creditors in opposition to Wells Fargo further contend that the "sale" from HEL to Wells Fargo was not a sale in the ordinary course of the trade or calling of a dealer of heavy equipment such as HEL. They contend that whether a transaction is in the ordinary course of a trade or calling is a question of fact and will therefore depend upon all of the circumstances of the sale. In this particular case I am satisfied that transactions of the nature entered into between Wells Fargo and HEL were part of the ordinary course of trade for HEL. Of particular importance in coming to this conclusion is the clear intention that the Equipment would be entered into the short term rental inventory of HEL and there were specific provisions in the Equipment Leases preventing any dealing with the Equipment other than for the purpose of short term leases. This is a substantive distinction between (1) financing for the purposes of general inventory in a dealership business and (2) financing for the purposes of creating a block of equipment intended to be assets in the rental business. Therefore this documentation cannot be considered to be a mortgage under the **Bills of Sale Act** because it is not intended to operate as a mortgage or pledge.

[13] I am therefore satisfied that the failure to register the Bills of Sale (absolute) executed between HEL and Wells Fargo is not fatal to the validity of the Equipment Leases and that therefore the Equipment Leases are validity executed prior security interests under the PPSA.

Question 3: **Did Wells Fargo properly comply with the transition provisions of the PPSA in respect of the security agreements upon which it relies for its security interest in the equipment, and if not, what is the effect of the failure by Wells Fargo to comply with the transitional provisions of the PPSA?**

[14] As noted above, the Equipment Leases arose prior to the coming into force of the **PPSA**, and in accordance with s. 74(4) of the **PPSA**, the validity of a prior security interest is governed by prior law. Apart from the issue of whether or not Bills of Sale absolute had to be registered, there was no serious contest as to whether or not the Equipment Leases of Wells Fargo were properly executed and registered under the prior law. Therefore they could be continued under the **PPSA**. The **PPSA** provides that the registered and perfected status of a security interest that, on the commencement of the **PPSA**, was covered by an unexpired registration under the previous registration law, continues for only two years after the commencement of the **Act** but may be further continued by registration in accordance withe the **PPSA** (**PPSA**, R.S.N. 1998 c. P-71, ss. 74 and 75).

[15] Registration "in accordance with the **Act**" is the subject of s. 26 of the Personal Property Security Regulations. 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**. [Emphasis added.]
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> (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**
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> (a) indicate under which prior registration law the security interest to which the registration relates is registered;
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> (b) enter the registration number under prior registration law;
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> (c) ... indicate the venue in which the registration under prior registration law is registered;
>
> ....

(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." [See Personal Property Security Regulations, N.R. 103/99.] [Emphasis added.]

[16] Within the two year transitional provision of s. 75 of the **PPSA**, Wells Fargo registered financing statements in the correct name of HEL and listed the appropriate serial numbers for the Equipment in question. However it failed, within that two year period, to comply with the requirements of s. 26 of the Personal Property Security Regulations (the "Regulations") in that it failed to make any reference whatsoever to the prior security interests and their registration or other details as required by Regulation 26. It is generally agreed that without a proper transition of its security to the **PPSA**, the prior security interest would lapse upon the expiration of two years from the date that the Act came into effect. Again all counsel agreed that the financing statements filed by Wells Fargo under the **PPSA** could however secure its interest in the Equipment but only with an effective date of the registration of these financing statements under the **PPSA**, priority being lost in favour of those parties having a registered security interest prior in time to the purported but ineffectual financing statements purporting to continue the prior registered security interest.

[17] Wells Fargo has submitted that its failure to include the information stipulated as being mandatory by s. 26 of the Regulations can be cured by resort to s. 44(7) of the **PPSA** which provides "the validity of the registration of a financing statement is not affected by any defect, irregularity, omission or error in the financing statement unless the defect, irregularity, omission or error in the financing statement is seriously misleading." Section 44(9) of the **PPSA** states that "in order to establish that a defect, irregularity, omission or error is seriously misleading, it is not necessary to prove that anyone was actually mislead by it."

[18] I am satisfied that the Equipment in the hands of HEL was "inventory" under the **PPSA** as it was goods held by a person for lease (**PPSA**, s. 2(x)(i)). "Equipment" as that term is defined under the **PPSA** is "goods that are held by a debtor other than as inventory or consumer goods". Serial number descriptions of the Equipment are therefore not required for **PPSA** registration and priority purposes. Thus inclusion of the serial numbers of the Equipment in the new financing statements of Wells Fargo does not aid Wells Fargo in its argument that the omission of the registration details of the Equipment Leases under the prior law was not seriously misleading. This is

because no searcher would be expected, when searching for encumbrances on the "inventory" of HEL, to do a serial number search.

[19] The creditors opposed to Wells Fargo submit that s. 44(7) of the **PPSA** cannot operate to remedy or cure a total disregard for the specific and mandatory provisions of the **Act** and Regulations which must be complied with before a secured party can take advantage of the continuation provisions. They say s. 44(7) cannot cure an incurable defect. In **Drake v. Snook, the Royal Bank of Canada and Martin,** [1985] Carswell Nfld. 21 (Nfld. C.A.), the Court of Appeal stated with respect to the curative section of the **Bills of Sale Act** (s. 21) "... despite the obviously broad wording of the curative sections, such a section cannot operate to remedy or cure a total disregard of the specific and mandatory provisions of the **Act** which must be complied with to make a documented bill of sale within the meaning of the **Act**, as well as those provisions that are a prerequisite to the registration thereof. In other words, s. 21 cannot cure an incurable defect." The creditors opposed to Wells Fargo submit that s. 44(7) of the **PPSA** ought not to be interpreted to, in effect, create compliance with the mandatory provisions of the Regulations required to establish continuation of a registered and perfected prior security interest when, in fact, there has been no such compliance and users of the personal property security registry system have not been given, or in any way been alerted to, the information deemed mandatory.

[20] These opposing creditors contend that the test to be applied is an objective one, which can be paraphrased as follows: "Would the defect, irregularity, omission or error be seriously misleading to any reasonable person within the class of persons for whose benefit registration of other methods of perfection are required?" (See **Kelln (Trustee of) v. Strasbourg Credit Union Ltd.**, [1992] Carswell Sask. 41 (Sask. C.A.) They assert that the inquiry should not be limited to the effect of the error on the party challenging the registration. Rather, they contend, one must determine the probability of some member of the class of persons that might search the system for prior registrations being materially mislead by the defect. (See **Re Lambert,** [1994] 7 PPSAC (2nd) (Ont.C.A.).) These creditors contend that the purposes of the **PPSA** registration system include the provision of information about a transaction and a means whereby a person who is intending to purchase personal property or to lend money on the security of personal property can determine whether the owner has granted a security interest in the property as security for a debt. The putative purchaser or leader wants to know whether there are any prior claims on the property which could affect the decision to buy the property or accept it as collateral. They contend that, even where a search reveals a financing statement registered by a secured party, persons

searching the **PPSA** Registry can be seriously misled by the contents of the financing statement. Further, they contend that the date of registration by a secured party is of significant importance to searches who will use that information to assess their relative priority. They contend the **PPSA** Registry must speak for itself, and the system must have certainty and reliability built into it. The contention is that a searcher ought to be able to assume that the registrant intended to include the information which appears on the financing statement. The searcher further ought to be able to assume that the registrant intended the date of registration of the financing statement to be the effective date of the registration unless the contrary intention is evidenced. They assert 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 legislation. In support thereof they refer to **Adelaide Capital Corp. v. Integrated Transportation Finance Inc.**, [1994] Carswell Ont. 256 (Ont. Gen. Div.) and **Central Guarantee Trust Co. v. Red Coach Rentals Corp.**, [1995] Carswell Ont. 57 (Ont. Gen. Div.). The opposing creditors assert that a finding by this Court in favour of Wells Fargo that there is no requirement to strictly comply with the mandatory provisions of Regulation 26 to transition and preserve Wells Fargo's **PPSA** security will introduce an unacceptable element of uncertainty into the **PPSA** registration system, and will destroy the integrity of the notice system as it was intended by the legislator. They say that the class of users which is relevant for the application of the objective test for cure set out in s. 44(7) necessarily includes all users of the **PPSA** registration system including users of the system after the expiry of the two year transitional period on December 13, 2001. After that date, they contend that users of the **PPSA** were entitled to rely on the provisions of the **PPSA** which provide that an unexpired registration under prior registration law continues for only two years after the commencement of the **PPSA** unless further continued. They conclude that a prudent user of the **PPSA** Registry system would not after December 13, 2002 have searched under the prior law. In this respect they are supported by s. 74(14(b) of the **PPSA** which provides that a registration upon the **PPSA** made for the purpose of continuing the registered and perfected status of prior law security supercedes a registration or perfection under prior law. Clearly the drafters of the **PPSA** by this clause intended the **PPSA** Registry, after expiry of the two year transition period, to be the only registry to search for notice of consensual personal property security.

[21] The creditors in opposition to Wells Fargo contend that there are situations where the user of the **PPSA** Registry would be seriously misled by the results of a search against HEL which revealed the Wells Fargo financing statements, but which show no reference to pre-**PPSA** registrations whatsoever. They contend that the

following two examples illustrate how a reasonable prudent leader, conversant with the search facilities, and a reasonable competent user of the registry system would be seriously misled by the financing statements (if the financing statements are "cured" so as to provide Wells Fargo with priority dating back to its pre-**PPSA** filings under the **Conditional Sales Act**):

(i) In July 2002, a Secured Party (SP1) wishes to sell its security against the debtor to a new Secured Party (SP2). SP1 has a general security agreement and it is registered in February 2000. SP2 does a search against the debtor and finds a registration by Wells Fargo in March 2000, which describes inventory of the debtor, but does not indicate any pre-**PPSA** registration. SP2 concludes that SP1 has priority as the first to file, purchases SP1's security, and a financing change statement is registered to reflect the new secured party. If Wells Fargo is allowed to assert a pre-**PPSA** priority over SP2, SP2 would have been seriously misled to its detriment by the **PPSA** Registry system.

(ii) In February 2000, a lender makes a **PPSA** filing for a three year period against all assets of a potential debtor, but does not order post-registration searches 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 shows a registration by Wells Fargo in March 2000 which describes inventory of the debtor but does not indicate any pre-**PPSA** registration whatsoever. The lender concludes that it has priority over Wells Fargo because the lender is first to file. If Wells Fargo is allowed to assert a pre-**PPSA** priority against the lender, the lender will have been seriously misled to its detriment by the **PPSA** Registry system.

[22] Wells Fargo on the other hand contends that a fundamental purpose for the introduction of the **PPSA** was to do away with archaic technical rules that had developed under the prior law. They contend that the new statutory regime seeks to facilitate commerce and, for that purpose, is to be given a liberal interpretation. The statutory scheme of the **PPSA** is distinct from the prior law in that it does not give notice of transactions or documents but rather has as its fundamental purpose the giving of notice, to third parties, of interests held and to then provide a mechanism under which a third party with a legitimate interest may obtain particulars of their security

interests held, the state of advance and the current account. Wells Fargo contends that the omission to include the prior registration information required by s. 26 of the **PPSA** Regulations does not fundamentally affect the registration and would not seriously mislead any third party utilizing the Registry system. They contend that in a notice system of registration, the fundamental items of information are the correct name of the debtor, the name and address for inquiry for the secured party and the generic description of the collateral as "goods", "inventory", et cetera. There can be many other characteristics of a particular security interest which affect any final determination of priorities and which are not disclosed by the bare registration record. The question of whether or not the security interest, in fact, records a super-priority purchase money security interest in inventory is not discernable from the registration record. The scheme of the statute clearly requires persons requiring full information for priorities determinations to make further inquiries in accordance with their rights under s. 19 of the **PPSA**. Essentially therefore the argument is that no creditor or perspective purchaser would rely merely upon the information revealed in the **PPSA** Registry to make any loan or purchase decisions and that any reasonable searcher would recognize that review of all of the actual security documents, the existence of which is revealed by the **PPSA** Registry, is necessary and prudent and in fact intended by the drafters of the legislation.

Conclusion

[23] Notwithstanding the assertions by Wells Fargo, I am satisfied that the omission by Wells Fargo in its financing statements of March 2000, of the required particulars under Regulation 26 of the **PPSA** security, is seriously misleading and not capable of being cured under s. 44 of the **PPSA**. As stated earlier the test is objective. There can be many users of the **PPSA** registration system, not all of whom can be reasonably expected to wish to review each and every piece of security issued by a debtor. A reasonable user of the Registry system may be prepared to accept the risk that purchase money security interests in existence may not as yet be registered and could in fact be validly registered and perfected after that particular user makes its investment or purchased decision. The mere fact that such purchase money security interest can be effectively registered after the putative lender or buyer makes its investment or purchased decision, does not invalidate or render unreasonable that putative purchaser/lender's decision to rely upon what is revealed by the **PPSA** Registry. In the case at hand, the Wells Fargo security is not a purchase money security interest. Its proper registration in compliance with s. 26 of the Regulations would have revealed to such a putative lender/buyer the existence of pre-**PPSA** security properly continued

under the **PPSA**. The financing statements not having included the appropriate pre-**PPSA** registration information, the financing statements are as a result seriously misleading to at least some users of the system who can reasonably have been expected by the drafters of the legislation to have been relying upon the registration requirements which the drafters included in Regulation 26. I am satisfied that an error does not have to be misleading to all potential users of the Registry in order to be seriously misleading. I am therefore satisfied that the Equipment Leases held by Wells Fargo have not been properly transitioned under the provisions of the **PPSA** and that they have therefore lost whatever priority over the Equipment they may have held by reason of the pre-**PPSA** registrations. The claims of Wells Fargo to the Equipment arise in two other manners, namely:

(1) pursuant to the subsequently filed financing statements under the **PPSA** by Wells Fargo; and

(2) possibly by reason of subrogation to the security interests of John Deere Ltd.;

and remain to be adjudicated upon in the continuation of the hearing of this application.

[24] As a result of this ruling there is a requirement for a further continuation of the hearing of this matter in order to:

(1) provide an opportunity for creditors to provide further evidence and argument with respect to the subrogation and other arguments put forward by Wells Fargo; and

(2) to determine whether Hickman Leasing Limited, a purported purchaser for value without notice of the two pieces of equipment claimed by Wells Fargo, have an interest therein and further what the interest of their secured creditors may be in the Equipment.

[25] Any persons claiming any ownership or security interest in the Equipment which is the subject of the Wells Fargo application are therefore required to file any affidavit or documentary evidence with respect thereto and to file any further memoranda in relation thereto no later than February 7, 2003, after which date the Court will entertain applications for continuation of the argument in the present application and determination of any further applications ancillary thereto.

[Indexed as: **Kelln (Trustee of) v. Strasbourg Credit Union Ltd.**]

THORNE ERNST & WHINNEY INC. as the Trustee in Bankruptcy of the Estate of Wayne William Kelln
v.
STRASBOURG CREDIT UNION LIMITED

Saskatchewan Court of Appeal
Bayda C.J.S., Vancise and Wakeling JJ.A.

Heard – June 3, 1991.
Judgment – March 10, 1992.

Personal property security – Security interests under Personal Property Security Acts – Registration – Description of property – Security agreement covering truck – Financing statement omitting serial number – Debtor later going bankrupt – Omission of serial number on financing statement rendering registration invalid – Registration seriously misleading to reasonable person under s. 66(1) of Personal Property Security Act – Trustee's interest having priority over secured creditor's unperfected security interest.

The credit union took a security agreement from the debtor covering "all . . . vehicles" including those referred to in a schedule. A financing statement was later registered against "all . . . vehicles," but no serial numbers were set out as required by the *Personal Property Regulations*. The vehicles were "consumer goods or equipment" in the hands of the debtor. The debtor later made an assignment in bankruptcy. On the trustee in bankruptcy's application, the chambers judge found that the security interest of the credit union in the truck took priority over that of the trustee. The trustee appealed.

Held – Appeal allowed.

Per VANCISE J.A. (WAKELING J.A. concurring): Perfection of a security interest by registration is achieved under s. 25 of the *Personal Property Security Act* by filing a financing statement which contains the information required by the Regulations. The Regulations require serial number description registration of a motor vehicle when it is consumer goods or equipment in the hands of a debtor. On a plain reading of s. 5(1)(*i*) of the Regulations, this requirement is mandatory. Failure to comply with the mandatory provisions of the Regulations will result in the registration being invalid unless the defect can be remedied by s. 66(1) of the Act.

Failure to comply with all the registration requirements of the Act and Regulations in every respect will result in the security interest being unperfected. Debtor name is the universal registration-search criterion for all types of security transactions and collateral covered by the Act. The use of serial numbers as a registration-search criterion is an *additional* criterion to be used in the specific circumstances described in the Regulations. Thus there is a dual registration-search criterion and the two are not alternate criteria. Therefore, the registration was invalid and the security interest was unperfected in the absence of the curative provisions of s. 66(1) of the Act.

The function of s. 66(1) is to ensure that the personal property system functions properly and that minor defects in documents and registration will not be permitted to render the perfection of a security interest invalid. Section 66(1) contains an objective test. Non-compliance which would result in a reasonable person searching the register

being seriously misled is a failure to meet the minimum requirement. Failure to include both the name of the debtor *and* the serial number where it is required will result in the registration being seriously misleading and render the security interest unperfected. Here the collateral was consumer goods or equipment and therefore both registration-search criteria should have been included in the financing statement. As there was no description by serial number, the registration was seriously misleading and the security interest was not perfected. The interest of the credit union was therefore subordinate to that of the trustee in bankruptcy pursuant to s. 20(1) of the Act.

Per BAYDA C.J.S. (concurring): Section 5 of the Regulations provides that a financing statement shall describe a truck that is equipment or consumer goods in which a security interest is claimed by using a "description by serial number." The financing statement's entire omission of such a description was "a defect, irregularity, omission or error" within the meaning of s. 66(1). Whether a particular omission is seriously misleading depends upon whether a reasonable person using the registration and search systems is apt, because of the omission and surrounding circumstances, to believe that something important is so when in fact it is not so. Whether the test is characterized as "objective," "subjective," or "a hybrid" is not important. A reasonable person has the right to expect that a registering party shall ensure that a truck will be described in a financing statement by use of a "description by serial number." A reasonable person is apt, by reason of its omission, to believe that the registering party is claiming no interest in the truck when in fact it is claiming an interest. By itself this is "seriously misleading." The fact that a search using the debtor's name would have revealed the registering party's interest does not render the omission less than "seriously misleading." Therefore the phrase "seriously misleading" was applicable to the omission here, the financing statement was invalid as to the truck, and the credit union's security interest was subordinate to the trustee's interest.

Cases considered

Bank of Nova Scotia v. Royal Bank (1987), 8 P.P.S.A.C. 17, 58 Sask. R. 304, 42 D.L.R. (4th) 636, 68 C.B.R. (N.S.) 235 (C.A.) – referred to.

Barouss, Re (1983), 48 C.B.R. (N.S.) 315, 29 Sask. R. 6, 3 P.P.S.A.C. 61 (Q.B.) – considered.

Canadian Imperial Bank of Commerce v. Federal Business Development Bank (1984), 32 Sask. R. 77, 4 P.P.S.A.C. 50 (Q.B.) – considered.

Colliar v. Robinson Diesel Injection Ltd. (1990), 86 Sask. R. 198, 1 P.P.S.A.C. (2d) 123 (C.A.) – considered.

Elmcrest Furniture Manufacturing Ltd. v. Price Waterhouse (1985), 41 Sask. R. 125 (Q.B.) – not followed.

Ford Credit Canada Ltd. v. Percival Mercury Sales Ltd., [1986] 6 W.W.R. 569, 6 P.P.S.A.C. 288, 50 Sask. R. 268 (C.A.) [additional reasons (1986), 50 Sask. R. 270 (C.A.)] – distinguished.

Gibbons, Re (1984), 45 O.R. (2d) 664, 51 C.B.R. (N.S.) 235, (sub nom. *Re Gibbons; Touche Ross Ltd. v. Toronto Dominion Bank*) 4 P.P.S.A.C. 53, 3 O.A.C. 291, 8 D.L.R. (4th) 316 (C.A.) – referred to.

International Harvester Credit Corp. of Canada v. Frontier Peterbilt Sales Ltd., [1983] 6 W.W.R. 328, 48 C.B.R. (N.S.) 278, 28 Sask. R. 48, 149 D.L.R. (3d) 572, 3 P.P.S.A.C. 86 (Q.B.) – distinguished.

J.I. Case Credit Corp. v. Kerrobert Credit Union Ltd., [1984] 3 W.W.R. 471, 31 Sask. R. 243, 3 P.P.S.A.C. 298 (Q.B.) – considered.

Leaseway Autos Ltd. v. Sinco Sportswear Ltd. (Trustee of) (1986), 6 P.P.S.A.C. 92, 45 Sask. R. 254, 60 C.B.R. (N.S.) 297, (sub nom. *Leaseway Autos Ltd. v. Burlingham*) 25 D.L.R. (4th) 294 (Q.B.) – considered.

Peat Marwick Ltd. v. General Motors Acceptance Corp. of Canada, [1990] 4 W.W.R. 282, 78 C.B.R. (N.S.) 217, 1 P.P.S.A.C. (2d) 30, 69 D.L.R. (4th) 307, 84 Sask. R. 104 (Q.B.) – not followed.

Statutes considered

Personal Property Security Act, S.S. 1979-80, c. P-6.1
- s. 12(1) – referred to.
- s. 19 – considered.
- s. 20(1)(*d*) – considered.
- s. 25 – considered.
- s. 64(2) – referred to.
- s. 66(1) – considered.
- s. 73(*g*) – considered.
- s. 73(*j*) – referred to.

Regulations considered

Personal Property Security Act, S.S. 1979-80, c. P-6.1
Personal Property Security Act Regulations, Reg. 1
- s. 5(1)(*i*)
- s. 5(1)(*j*)

APPEAL from order of MACPHERSON C.J.Q.B., [1990] 5 W.W.R. 670, 80 C.B.R. (N.S.) 310, 1 P.P.S.A.C. (2d) 128, (sub nom. *Re Kelln*) 85 Sask. R. 231, dismissing application by trustee in bankruptcy for order requiring credit union to deliver truck or proceeds of sale thereof to trustee.

D.M. Appleton, for appellant.
T.S. Quinlan, for respondent.

(Doc. 645)

March 10, 1992. VANCISE J.A. (WAKELING J.A. concurring):–

INTRODUCTION

1 The Strasbourg Credit Union claims an interest in collateral in priority to Thorne Ernst & Whinney Inc., a trustee in bankruptcy. The credit union did not comply with the registration requirements of the *Personal Property Security Act Regulations*, S.S. 1979-80, c. P-6.1, Reg. 1, when registering its security interest. The issues on appeal [from [1990] 5 W.W.R. 670, 80 C.B.R. (N.S.) 310, 1 P.P.S.A.C. (2d) 128, (sub nom. *Re Kelln*) 85 Sask. R. 231] are reduced to whether there was sufficient compliance with the *Personal Property Security Act*, S.S. 1979-80, c. P-6.1 to perfect the security interest of the credit union and if not, whether the non-compliance can be saved by the curative provisions of the Act.

FACTS

2 William Kelln made an assignment in bankruptcy in favour of Thorne Ernst & Whinney, trustee in bankruptcy. On September 16, 1988 the Strasbourg Credit Union claimed an interest in a 1966 GMC three-ton truck in priority to the trustee pursuant to a security agreement dated February 8, 1988 covering "all machinery, equipment, tools and vehicles including those covered in Schedule 'A'." Schedule "A" identified the 1966 GMC three-ton truck by serial number. The security agreement was perfected on March 3, 1988 by the registration of a financing statement which described the collateral as "all machinery, equipment, tools, and vehicles." It did not contain a description of the vehicle by serial number. The parties agree that the collateral is "consumer goods or equipment" in the hands of the debtor.

DECISION OF THE CHAMBERS JUDGE

3 The sole issue before the chambers judge was whether the credit union's security agreement was subordinate to the interest of the trustee in bankruptcy pursuant to s. 20(1) of the *Personal Property Security Act*. To decide that issue it was necessary for him to determine the effect of the failure by the credit union to register a financing statement which contained the information required by s. 5(1) of the *Personal Property Regulations*.

4 The chambers judge found the security agreement was perfected by registration prior in time to the interest of the trustee in bankruptcy, that the failure to include the information required by s. 5(1) of the regulations was not "seriously misleading" within the meaning of s. 66(1) of the Act and did not cause the trustee to act to its detriment. In his opinion, a search of the debtor's name would permit the trustee to discover the credit union's interest in "all machinery, equipment, tools and *vehicles*" (his emphasis) and, as a result, the trustee could have obtained a copy of the security agreement in which the truck was described by serial number had it sought to do so.

5 He found that the failure to identify the vehicle by serial number was one of the circumstances contemplated by s. 66(1) of the Act which permits the override of the regulations, and did not invalidate the perfection of the security interest by registration. As a result, the security interest of the credit union took priority over that of the trustee.

RELEVANT LEGISLATION AND REGULATIONS

6 The relevant sections of the *Personal Property Security Act* are the following:

19. A security interest is perfected when:

(*a*) it has attached; and

(*b*) all steps required for perfection under this Act have been completed;

regardless of the order of occurrence.

20.(1) An unperfected security interest is subordinate to the interest of . . .

(*d*) a representative of creditors, but only for the purposes of enforcing the rights of persons mentioned in clause (*b*), and a trustee in bankruptcy . . .

25. Subject to section 19, registration of a financing statement perfects a security interest in any collateral but only during the period in which the registration of the financing statement or a financing change statement renewing the registration relating thereto is effective.

66.(1) The validity or effectiveness of a document to which this Act applies is not affected by reason of a defect, irregularity, omission or error therein or in the execution or registration thereof unless the defect, irregularity, omission or error is seriously misleading.

73. For the purpose of carrying out the provisions of this Act according to their intent, the Lieutenant Governor in Council may make regulations . . .

(*g*) prescribing the form and content of . . .

(*i*) financing statements and financing change statements required or permitted to be registered in the registry under this or any other Act, and the manner of their use and for requiring that such documents used, or any of them, must be those provided by the registrar;

(*ii*) notices required or permitted to be filed under section 54 in a land titles office and the manner of their use.

Section 5 of the regulations and in particular s. 5(1)(*i*) and (*j*) read as follows:

5.(1) The registering party shall ensure that a financing statement registered pursuant to this Part contains, in the appropriate area designated on the form . . .

(*i*) where a security interest is claimed in a motor vehicle, trailer, mobile home or airplane and the collateral is consumer goods or equipment, a description by serial number, which description must include:

(i) the last 18 characters of the serial number or, in the case of an airplane, the registration marks assigned to the airplane by the Ministry of Transport, omitting the hyphen which is normally part of such registration marks;

(ii) the make, or where there is no make the manufacturer, and the model;

(iii) the type of code as one of airplane, bus, car, mobile home, motorcycle or motor bike, motor home, snowmobile or motor toboggan, trailer, truck, van or other;

and may include:

(iv) the last two digits of the model year;

(v) the colour code as one of grey, white, black, red, green, blue, yellow, orange, purple, brown or other;

(*j*) where a security interest is claimed in collateral other than that required to be described in accordance with clause (*i*), a description of the collateral which enables the type or kind of collateral taken under the security agreement to be distinguished from types or kinds of collateral which are not collateral taken under the security agreement, but in the case of a security interest taken in all of the debtor's present and after-acquired property, a statement indicating that a security interest has been taken in all of the debtor's present and after-acquired property is sufficient . . .

ISSUE

7 The primary issue is whether the filing of a financing statement which properly describes the debtor but describes the collateral as "vehicles" when the collateral is consumer goods or equipment in the hands of the debtor, but does not contain a description by serial number as required by s. 5(1)(*i*) of the *Personal Property Act Regulations*, is sufficient compliance with the Act and regulations to perfect the security interest of the credit union. If it is not, the second issue is whether the failure to provide the registration-search criterion required by the regulations can be saved by the operation of s. 66(1) of the Act.

8 The resolution of this issue requires consideration and examination of a number of subordinate questions, the answer to which impact on the result.

9 1. Registration requirements.

(a) Is description by serial number of a motor vehicle mandatory in order to perfect the security interest by registration when the collateral is either consumer goods or equipment in the hands of the debtor? or,

(b) Is it mandatory to describe both the vehicle by serial number and the debtor by name in order to satisfy the registration requirements of the regulations to perfect the security interest in a motor vehicle when the collateral is consumer goods or equipment in the hands of the debtor?

(c) Is description of the debtor by name alone sufficient to satisfy the registration requirements of the regulations to perfect the security interest in a motor vehicle when the collateral is either consumer goods or equipment in the hands of the debtor?

10 2. The curative provisions of s. 66(1).

What is the extent of the power contained in s. 66(1) of the Act to validate the registration of a document in the event of an error, defect, irregularity, or omission in the document?

REGISTRATION REQUIREMENTS

General Comments

11 The *Personal Property Security Act* is a commercial code, subject to the provisions of s. 64(2), which creates a scheme of priorities for security interests in consensual transactions. Section 12(1) provides that a security interest attaches when value is given; the debtor has rights in the collateral; and, it (subject to certain exceptions which are not relevant here) becomes enforceable, unless the parties intend it to attach at a later time.

12 Section 19 provides that the security interest is perfected when it attaches (in accordance with s. 12) and all steps required for perfection have been completed.

13 Section 25 provides for perfection of a security interest by the registration of a financing statement. Registration of a financing statement is a universal form of perfection under the Act.

14 There is no statutory form of financing statement in the Act itself but s. 73 of the Act, and in particular subss. (*g*) and (*j*), grant the Lieutenant Governor in Council the power to make Regulations for the purpose of carrying out the provisions of the Act. Section 5(1) of the Regulations which was created pursuant to such power, establishes the form and content of the financing statement which is required to be filed in order to perfect a security interest by means of registration in non-possessory collateral.

15 Perfection of a security interest by registration is achieved under s. 25 by filing a financing statement which contains the information required by the Regulations.

16 Prior to examining the registration requirements contained in s. 5(1) of the Regulations, it would be useful to briefly describe the operation of the Personal Property Registry to set out the search criteria which were established and to describe how they are used to identify personal property and security interests registered under the system. The Act does not provide for the filing of copies of security agreements. It provides for the filing of a financing statement which, if properly completed and registered, discloses information concerning consensual security transactions. The Personal Property Registry is designed to permit computer-assisted searches using as criteria the debtor's name as a universal criterion, and in a specified number of types of collateral the serial number as an alternative criterion.

17 Serial number registration is an attempt to provide a solution to problems which arise, or can arise, where registration is by the name of the debtor only, particularly in multiple or successive transactions, where the person searching the registry is unaware or uncertain whether someone other than the person whose name is used as the search criterion has an interest in the collateral which would have priority. The regulations of the Personal Property Registry require serial number description registration of a motor vehicle (as defined in the regulations), trailer, mobile home or airplane, when the collateral is consumer goods or equipment in the hands of the debtor. For a detailed explanation of the operation of the registration system, including partnerships, bodies corporate and other artificial bodies, see R. Cuming, *Modernization of Personal Property Security Registries* (1985), 48 Sask. Law Rev. 189 at p. 191 et seq. Professor Cuming points out that the largest number of errors in the description of collateral are the result of a failure by creditors to correctly describe the name of the debtor or the serial number of consumer goods or equipment. The two registration-search criteria is Professor Cuming's term used to describe the retrieval of information from the registry. A failure to properly describe either or both of these descriptors can result in a person who searches the registry not finding the collateral and the security interest or both. That leads one to ask whether errors, irregularities, or defects in the description of either or both of the search criteria which affect the searchability of the registration should be treated differently from errors in the description of nonregistration-search criteria such as the description of the make or model of the collateral or the failure to include a portion of a business name or partnership which do not affect the searchability of the registration.

Is Description of Collateral by Serial Number Mandatory?

18 The first issue which must be resolved is whether certain collateral, such as automobiles, that is, consumer goods or equipment in the hands of the debtor, must be described by serial number in order to perfect the security interest. Is the description by serial number mandatory in the circumstances?

19 Regulation 5(1) is the governing or controlling regulation and in particular subss. (*i*) and (*j*) which are again reproduced for ease of reference:

> 5(1) The registering party shall ensure that a financing statement registered pursuant to this Part contains, in the appropriate area designated on the form . . .
>
> (*i*) where a security interest is claimed in a motor vehicle, trailer, mobile home or airplane and the collateral is consumer goods or equipment, a description by serial number, which description must include:

(i) the last 18 characters of the serial number or, in the case of an airplane, the registration marks assigned to the airplane by the Ministry of Transport, omitting the hyphen which is normally part of such registration marks;

(ii) the make, or where there is no make the manufacturer, and the model;

(iii) the type code as one of airplane, bus, car, mobile home, motorcycle or motor bike, motor home, snowmobile or motor toboggan, trailer, truck, van or other;

and may include:

(iv) the last two digits of the model year;

(v) the colour code as one of grey, white, black, red, green, blue, yellow, orange, purple, brown or other;

(*j*) where a security interest is claimed in collateral other than that required to be described in accordance with clause (*i*), a description of the collateral which enables the type or kind of collateral taken under the security agreement to be distinguished from types or kinds of collateral which are not collateral taken under the security agreement, but, in the case of security interest taken in all of the debtor's present and after-acquired property, a statement indicating that a security interest has been taken in all of the debtor's present and after-acquired property is sufficient.

20 The regulations state that a financing statement "shall" contain the serial number when a security interest is claimed in collateral such as a motor vehicle and the collateral is consumer goods or equipment. Is that requirement mandatory, and if it is, does the failure to describe the collateral by the serial number in the financing statement mean that the security interest is unperfected?

21 The wording of the regulation is clear, unambiguous, and unequivocal. The registering party *shall* ensure that the financing statement contains . . . a description by serial number of a motor vehicle which *must* also contain certain other information as specified in the regulations. On a plain reading of the regulations the description by serial number is mandatory when a security interest is claimed in a motor vehicle which is consumer goods or equipment in the hands of the debtor. It is an inescapable conclusion that the failure to comply with the mandatory provisions of the regulations will result in the registration being invalid unless the defect can be remedied by s. 66(1) of the Act.

Description by Debtor Name Only

22 The second issue is whether only the description of the debtor by name, the universal search criterion, under the Act is sufficient to perfect the security interest in the collateral. It follows from what has already been said that such description is mandatory in transactions which do not require serial number description as one of the registration search criteri-

on and that an error in such description can make the security interest unperfected, subject to the effect of s. 66(1) of the Act.

23 If the creditor files a financing statement in a transaction which requires that the collateral be described by serial number correctly describing the debtor by name but describes the collateral only in a general way as "vehicles" and does not identify it by serial number is the description of one of the two registration-search criterion sufficient to validly perfect the security interest? In that type of transaction, there are two mandatory registration-search criteria, the name of the debtor and the serial number. Are the two mandatory registration-search criteria alternatives one to the other, or are they inseparable and not alternate registration-search criteria? Are the registration-search criteria alternatives or are they both required to properly register the security interest? If they are alternatives, are they true alternatives or is one mandatory and the other merely secondary?

24 Those questions arose, although not directly, in *Ford Credit Canada Ltd. v. Percival Mercury Sales Ltd.*, [1986] 6 W.W.R. 569, 6 P.P.S.A.C. 288, 50 Sask. R. 268 (C.A.). There the trustee in bankruptcy attacked the "security interest" of the lessor of an automobile who claimed a security interest in priority to the trustee. The lessor had registered a financing statement which described the collateral (a vehicle) by make, model, and serial number, but failed to identify the lessee as the "debtor" as required by s. 35 of the regulations.

25 The court considered whether the failure to include the name of the debtor in the financing statement was "seriously misleading" within the meaning of s. 66(1) of the Act, concluded that it was not, that the security interest was properly perfected and took priority over the statutory interest of the trustee in bankruptcy. The court noted that there was a requirement to set out not only the name of the debtor but also a description of the collateral by serial number, make and model. It went on to state that there are therefore two search methods open to a searching party and in the case of an automobile the serial number is the preferable search criterion and the "primary means of description."

26 What it did not consider was whether the two registration-search criteria are true alternatives in a transaction where the person searching or seeking to set aside the registration is a person who has a choice to use either the name of the debtor or the serial number of the collateral as the registration-search criteria. Such a person could be involved in the sale and financing of automobiles which are inventory and which do not re-

quire that the collateral be described by serial number. In that case the person dealing with the debtor in possession of the chattels as inventory has to do no more than describe the name of the debtor and describe the collateral in a general way in order to perfect the security interest. A search of the registry will reveal the creditor's interest in the inventory. If, however, the serial number is paramount or the primary search criterion, the creditor or third party searcher will not be able to rely on such a search.

27 The regulations require serial number description of specific types of collateral only when it is held in the hands of the debtor as consumer goods or as equipment. There are thus two indices which determine whether a detailed description is required, the type of collateral, and the capacity in which it is being held. If the creditor proceeds on the basis that goods are inventory in the hands of the debtor there is no need for him to obtain more than a search of the name of the debtor. He has in those circumstances satisfied the registration-search requirement and his security interest should not be subject to being set aside because he failed to describe the collateral by the preferable or primary registration-search criterion.

28 More fundamentally, what the court did not consider was whether the dual registration-search criteria in those circumstances created a scheme where both criteria are required in order to perfect the security interest. If only one of the criteria is required, why would the legislature require as it did that there be two – the debtor's name, and the serial number of the collateral. If the two registration-search criteria is required to perfect the security there is less chance of inconsistent or circular search results in competing claims for priority between creditors.

29 I conclude that debtor name is the universal registration-search criterion for all types of security transactions and collateral covered by the Act. The use of serial numbers as a registration-search criterion is an *additional* criterion to be used in the specific circumstances described in the regulations to provide more protection for third parties dealing with the debtor or the collateral. It was not intended to replace the debtor name as a registration-search criterion. Thus there is a dual registration-search criterion and the two are not alternate criterion.

30 It follows that the failure to include the name of the debtor in a financing statement where the creditor has properly described the collateral by serial number will render the registration invalid, subject of course to the effect of s. 66(1) of the Act. The regulations must be read in conjunction with that section of the Act.

31 I conclude that a failure to comply with all the registration requirements of the Act and the regulations in every respect will result in the security interest being unperfected: see *Bank of Nova Scotia v. Royal Bank* (1987), 8 P.P.S.A.C. 17, 58 Sask. R. 304, 42 D.L.R. (4th) 636, 68 C.B.R. (N.S.) 235 (C.A.); see also the Ontario Court of Appeal in *Re Gibbons* (1984), 45 O.R. (2d) 664, 51 C.B.R. (N.S.) 235, (sub nom. *Re Gibbons; Touche Ross Ltd. v. Toronto Dominion Bank*) 4 P.P.S.A.C. 53, 3 O.A.C. 291, 8 D.L.R. (4th) 316 (C.A.). The result is that the registration is invalid and the security interest is unperfected in the absence of the curative provisions of s. 66(1) of the Act.

THE CURATIVE PROVISIONS OF SECTION 66

32 There are two competing approaches to the interpretation of s. 66(1) in the Court of Queen's Bench. The first is that the section must be interpreted subjectively, that is that the defect, irregularity or omission was seriously misleading to the person adverse in interest to the creditor. The second is that the section must be interpreted objectively, that is, that it is not necessary to consider whether the particular person adverse in interest has been affected, but rather whether all hypothetical users of the system would be seriously misled.

33 If one examines s. 66(1) of the Act, it is clear that its function is to ensure that the personal property system functions properly and that minor defects in documents and registration or matters of inadvertence should not be permitted to render the perfection of a security interest of a person adverse in interest invalid. It is necessary to examine and determine to what extent the failure to include *all* the required information in the financing statement will render the document invalid as against a party adverse in interest by reference to s. 66. Is the failure to include the mandatory registration-search criteria or one of them, an error, irregularity or defect, in the mandatory registration-search criteria curable? Are errors in the description of the supplementary information and description the only errors which are curable and which do not affect the validity of the registration? Is such a defect or irregularity so fundamental as to always be misleading?

34 What then is the proper approach? I propose to refer to and analyze the two approaches taken in the Court of Queen's Bench and to establish certain rules to determine when an error, irregularity, or defect in description or registration of a document is seriously misleading pursuant to s. 66 of the Act.

Objective Approach

35 The Court of Queen's Bench has adopted an objective test in a number of cases including: *Re Barouss* (1983), 48 C.B.R. (N.S.) 315, 29 Sask. R. 6, 3 P.P.S.A.C. 61, referred to in *J.I. Case Credit Corp. v. Kerrobert Credit Union Ltd.*, [1984] 3 W.W.R. 471, 31 Sask. R. 243, 3 P.P.S.A.C. 298; *Canadian Imperial Bank of Commerce v. Federal Business Development Bank* (1984), 32 Sask. R. 77, 4 P.P.S.A.C. 50; and *Leaseway Autos Ltd. v. Sinco Sportswear Ltd. (Trustee of)* (1986) 45 Sask. R. 254, 6 P.P.S.A.C. 92, 60 C.B.R. (N.S.) 297, (sub nom. *Leaseway Autos Ltd. v. Burlingham*) 25 D.L.R. (4th) 294. In each case there was no finding that any one had actually been misled by the deficiency in registration. Thus the court appeared to consider the defect from the perspective that non-compliance which would result in a reasonable person searching the register being seriously misled is a failure to meet the minimum requirement. On that objective test the failure to correctly identify the debtor by name or the collateral by serial number (in those cases which require it) would result in the security interest being unperfected. In other words, a failure to comply with all the registration-search requirements is seriously misleading. It is not necessary to show that someone was actually misled by the deficiency.

Subjective Approach

36 There is another line of cases typified by *Elmcrest Furniture Manufacturing Ltd. v. Price Waterhouse* (1985), 41 Sask. R. 125, 5 P.P.S.A.C. 22 (Q.B.). In that case Wimmer J. concluded that s. 66(1) should be applied literally to validate documents which do not comply with the regulations where "no party has been misled or prejudiced." In other words, the purpose of the Act is to give notice to an interested party of an interest and where the notice has been given and no prejudice has occurred the registration will not be invalid. That approach introduces an air of uncertainty into the system, with the possibility of different results occurring, one unperfected, and the other perfected depending on the knowledge of the searching party. The section makes no reference to non-compliance having resulted in someone being misled or being prejudiced. On its face it appears to refer to an objective standard – would the defect be misleading to a reasonable searcher of the registry?

Hybrid Approach

37 There is a third approach which has been developed by Gerein J. in *Peat Marwick Ltd. v. General Motors Acceptance Corp. of Canada*, [1990] 4 W.W.R. 282, 78 C.B.R. (N.S.) 217, 69 D.L.R. (4th) 307, 84

Sask. R. 104, 1 P.P.S.A.C. (2d) 30. He held that the curative provision in s. 66(1) is to be interpreted objectively but not exclusively objectively. In his opinion the surrounding circumstances should be taken into account to determine whether the error was seriously misleading. With respect, that is simply another subjective test (what is the impact on the third party, what actual prejudice has the third party suffered?) under the guise of an objective test.

38 In my opinion s. 66(1) contains an objective test. In interpreting the section it is interesting to note what it does not say. It does not say that the registration or document is valid unless it has actually misled a third party whose interest has been affected by the registration. It does not state that the registration is valid unless some person has been prejudiced by the registration. What it does say is that the registration is valid and effective unless a defect or irregularity is seriously misleading. Seriously misleading to whom? The inference is clear as Professor Cuming points out in his article "Judicial Treatment of the Sask. Personal Property Security Act" (1986-87), 51 Sask. Law Rev. 129 at 137:

> On the surface at least, it appears to state an objective test which may be paraphrased as follows: 'Would the defect, irregularity, omission or error be seriously misleading to any reasonable person within the class of persons for whose benefit registration or other methods of perfection are required?'

39 As noted above, the regulations must be read with and in light of s. 66(1) and the section contemplates the registration of a document which must contain certain information required by the Act and the regulations. The name of the debtor and the serial number (where required) are mandatory and the failure to include such information will result in an invalid registration. As Professor Cuming notes, that approach "perpetuates the basis approach taken by Saskatchewan courts in the context of the curative provisions of the Bills of Sale Act and the Conditional Sales Act." I agree with him and with the approach.

40 If there is an error or non-compliance in the name of the debtor or in the serial number the court will examine the error to determine whether the error will result in a reasonable person using the system being misled. If, as in *Leisurewear*, supra, where the omission was part of one of the registration-search criterion, i.e., the inclusion of the designation "Ltd." as part of a business name of the debtor, or as in *International Harvester Credit Corp. of Canada v. Frontier Peterbilt Sales Ltd.*, [1983] 6 W.W.R. 328, 48 C.B.R. (N.S.) 278, 28 Sask. R. 48, 149 D.L.R. (3d) 572, 3 P.P.S.A.C. 86 (Q.B.), where the error which occurred in the serial numbers was not the crucial or critical characters or numbers for the accurate description and registration of the collateral, no reasonable person using

the registry would be seriously misled. It would be otherwise if the error, irregularity, or defect would result in the failure to properly register or retrieve the information from the register concerning the collateral.

41 The registering party is required to include in his financing statement the name of the debtor *and* the serial number for certain types of collateral. Thus the failure to include the serial number when required to do so is seriously misleading. Is the failure to include the serial number on a financing statement where the name of the debtor has been included seriously misleading? The response must be "yes" because the test is objective and not subjective. The test is not whether the particular person using the registry is misled but rather whether hypothetical users of the registry, which would include persons who only have the serial number of the collateral available as a search criterion, would be misled. Thus the conclusion is that the failure to include both of the mandatory registration-search criterion where it is required will result in the registration being seriously misleading and render the security interest unperfected.

42 As noted, the reason for such objective interpretation is to provide a consistent approach to the registration and perfection of security interests.

43 The failure to include the debtor's name on a financing statement where there is already a serial number which correctly describes the collateral should render the security interest unperfected. In other words, where there is a requirement for both criterion the failure to include one is seriously misleading and the failure to comply renders the registration invalid. If one or both of the mandatory registration-search criteria contain errors which do not prevent the proper identification or retrieval of the financing statement, the error is not seriously misleading and the security interest should be perfected.

Disposition

44 In this case the creditor described the collateral by the name of the debtor. The collateral is consumer goods or equipment and therefore one of the types of transactions which require that both registration-search criterion be included in the financing statement. There was a complete absence of description by serial number and the registration is therefore seriously misleading and the security interest is not perfected. The interest of the credit union is therefore subordinate to the interest of the trustee in bankruptcy pursuant to s. 20(1) of the Act.

45 The appeal is allowed and the credit union ordered to deliver or pay over to the trustee in bankruptcy the proceeds of the sale of the collateral which was the subject matter of the application.

46 The trustee in bankruptcy shall have its costs on the appropriate column of the Queen's Bench tariff where applicable and on double col. 5 for all taxable items in this court.

47 BAYDA C.J.S. (concurring):– The facts are simple and are stated in the reasons for judgment prepared by my colleague Vancise. The critical issue in the appeal is whether the failure to include in the March 3, 1988 financing statement the serial number of the truck in question renders that financing statement invalid or ineffective (insofar as the truck is concerned) for the purposes of the *Personal Property Security Act*, S.S. 1979-80, c. P-6.1. If the statement is invalid or ineffective the security interest that Strasbourg Credit Union Limited claims in the truck has not been perfected by registration of that statement; and that security interest is subordinate to the interest of the trustee in bankruptcy, Thorne Ernst & Whinney. On the other hand, if the financing statement is valid and effective the credit union's security interest has been perfected and it is not subordinate to the interest of the trustee.

48 Validity and effectiveness in this context are almost invariably determined by an application of s. 66(1) of the Act. That is a natural starting point:

> 66(1) The validity or effectiveness of a document to which this Act applies is not affected by reason of a defect, irregularity, omission or error therein or in the execution or registration thereof unless the defect, irregularity, omission or error is seriously misleading.

Two sub-issues arise:

(1) Is the failure to include in the financing statement the serial number of the truck in question "a defect, irregularity, omission or error" within the meaning of s. 66(1)?

(2) If it is, is that defect, irregularity, omission or error "seriously misleading" within the meaning of s. 66(1)?

49 The first sub-issue may be resolved quickly. Everyone agrees that s. 5 of the Regulations, promulgated under the Act, provides that a financing statement shall describe a truck that is equipment or consumer goods in which a security interest is claimed by using "a description by serial number" there more particularly defined. The financing statement in question entirely omits such a description. It is beyond argument that this omission is "a defect, irregularity, omission or error" within the meaning of s. 66(1). (There is no question here of holding that what is called a "defect, irregularity, omission or error" is not that at all, the variation or non-compliance being of such a magnitude as to justify a finding that what is called a financing statement is really not a financing statement.)

50 The second sub-issue is not as clear cut. Whether the adjectival phrase "seriously misleading" should be applied to a particular defect, irregularity, omission or error (hereinafter "omission") depends upon whether a reasonable person using the registration and search systems put in place by the Act is apt by reason of the omission and the circumstances surrounding it to end up believing that something important is so when in fact it is not so. That, in my respectful view, is the test that should be used to determine that issue (and whether the test is characterized as "objective," "subjective" or "a hybrid" is not important). This test is in consonance with this court's decisions in *Ford Credit Canada Ltd. v. Percival Mercury Sales Ltd.*, [1986] 6 W.W.R. 569, 6 P.P.S.A.C. 288, 50 Sask. R. 268; and *Colliar v. Robinson Diesel Injection Ltd.* (1991), 86 Sask. R. 198, 1 P.P.S.A.C. (2d) 123.

51 A reasonable person has a right to expect that a registering party "shall ensure," as s. 5 of the Regulations mandates, that a truck will be described in a financing statement by use of a "description by serial number." A reasonable person has the right to conduct a search as envisioned by the Act using the serial number of the truck to determine if there are any interests registered affecting that truck. By doing that, in the present case, a reasonable person is apt, by reason of the omission of the entire serial number in the financing statement, to end up believing that the registering party named in the financing statement, namely, the credit union, is claiming no interest in the truck (that search will not reveal any such interest) when in fact the credit union is claiming an interest. Were the analysis to go no further, there would be no doubt that the omission should be characterized as "seriously misleading."

52 To complete the analysis, however, one must go further and ask (i) whether a reasonable person who has conducted a search using a serial number and has found no interests affecting the truck, should be expected to then go on and conduct a search using the debtor's name and (ii) whether in the circumstances of this case such a search would have revealed the interest claimed by the credit union. The second part of that question may be readily answered. In the circumstances here a search using the debtor's name would likely have revealed the interest claimed by the credit union. It is the first part of the question that is not so readily answered.

53 Should a reasonable person foresee that registering parties will from time to time inadvertently omit something important from their financing statements? I think that the answer is yes but it does not follow that reason and logic therefore impose upon a person using the system a posi-

tive obligation (as for example an obligation to conduct a second search, that is, a search using the debtor's name) to mitigate or attempt to prevent any loss that may flow from that foreseeable omission. A reasonable person is entitled to rely on the assumption that the onus to prevent any such loss should in law rest not on him or her but upon the person responsible for the omission. This stance in reason and logic is supported by certain legal principles that the legislators likely intended should come into play when they enacted the Act. Because the Act is concerned with the status of titles (broadly speaking) to property and a system of registration which in large measure determines that status, the principles of certainty and predictability must predominate if the integrity of the system and efficacy of commercial transactions are not to be undermined. It is indisputable that these principles militate the need for accuracy in the recording of important information and the lack of carelessness in matters that count.

54 The stance is further supported by the venerable legal principle that a person shall not be allowed to take advantage of a negative condition brought about by himself or herself (2 Co. Litt 206 b per Sir Edward Coke). This principle and the principles of elemental fairness dictate that where the choices are relatively evenly balanced and it becomes necessary to choose between the person who is responsible for the omission and a person in the position of a reasonable person in our scenario, it is the former who should suffer any loss flowing from the omission.

55 In the result I find that where an omission consisting of a failure to use in a financing statement a "description by serial number," standing by itself, is found to be "seriously misleading," the fact that a search using the debtor's name would have revealed, in the circumstances present in that particular case, the interest claimed by the person responsible for the omission does not render the omission less than "seriously misleading."

56 It follows from the above analysis that the phrase "seriously misleading" should be applied to the omission in the present case. Accordingly, the financing statement insofar as it pertains to the truck must be found by virtue of s. 66(1) to be invalid and ineffective. The credit union's security interest in the truck was therefore not perfected and in the result is subordinate to the interest of the trustee.

57 I would allow the appeal with costs on double col. V.

Appeal allowed.

[Indexed as: **Lambert, Re**]

Re bankruptcy of JOSEPH PHILLIPE GILLES LAMBERT

Ontario Court of Appeal
Grange, Doherty and Weiler JJ.A.

Heard – February 16, 17 and 18, 1994.
Judgment – September 29, 1994.

Perfection of security interest – Registration – Errors in completing financing statements – Wrong or incomplete name of debtor – Incorrect first given name and initial for debtor in financing statement – Correct VIN for consumer goods motor vehicle in same financing statement – Curative provision applying and registration perfecting security interest, since reasonable person would have conducted both individual specific and VIN search, and VIN search would have revealed security interest – Personal Property Security Act, R.S.O. 1990, c. P.10, ss. 9(2), 19(b), 20(1)(b), 23, 45, 46(2), 46(4).

Perfection of security interest – Registration – Errors in completing financing statements – Application of curative provisions – Incorrect first given name and initial for debtor in financing statement – Correct VIN for consumer goods motor vehicle in same financing statement – "Reasonable person" test being objective – "Reasonable person" defined by Court of Appeal – Reasonable person performing both individual specific and VIN searches where collateral is motor vehicle – VIN search would have revealed financing statement – Curative provision applicable – Security interest perfected – Personal Property Security Act, R.S.O. 1990, c. P.10, s. 9(2), 19(b), 20(1)(b), 23, 45, 46(2), 46(4).

The bankrupt had purchased a motor vehicle under a conditional sales contract. The bankrupt's birth certificate name was "Joseph Phillipe Gilles Lambert". The secured party GMAC registered a financing statement under the *Personal Property Security Act* (Ont.) using the bankrupt's commonly used name, "Gilles J. Lambert", which was also the name on the vehicle registration document. The secured party recorded the correct birthdate and vehicle identification number ("VIN") in the same financing statement.

The trustee, relying on the birth certificate name, conducted a specific name search using "Joseph P. Lambert" and "Joseph G. Lambert" and the birthdate. These searches did not reveal the secured party's financing statement. A non-specific search using the name "Joseph Lambert" had the same result. The trustee did not conduct a VIN search, but if it had done so, a VIN search would have revealed the financing statement.

The secured party claimed that the curative provision, s. 46(4), should apply and that its registration should thus be held to be valid and its security interest in the vehicle be held to be perfected. The trustee in bankruptcy claimed that it should have priority over the secured party because the financing statement had not been completed in accordance with the regulations and thus the registration had not perfected the security interest. An unperfected security interest is subordinated to the trustee by a priority rule in the Act.

The trial judge held that s. 46(4) did not operate to cure the errors in the

debtor's first name and initial. Despite modifications to the curative provision in the revised Act, the secured party was still required to set out the "right" name of the debtor on the financing statement.

The secured party appealed the trial decision.

The trustee in bankruptcy argued that it was only required to do a specific individual search and that that search had in fact revealed no registration. Therefore, the error in the debtor's name could not be cured by operation of the curative provision and the security interest should be held to be unperfected and subordinate in priority to the trustee. The secured party argued that the trustee should also have done a VIN search which, in this case, would have revealed the registration. It argued that the curative provision should apply because the trustee in bankruptcy would not have been materially misled by the errors in the debtor's name contained in the financing statement if it had performed a VIN search, since the financing statement contained the correct VIN.

Held – The appeal was allowed.

Section 46(4) is potentially applicable to any error in a financing statement. An error does not *per se* invalidate the statement or impair the security interest claimed by it. The validity of a financing statement is unaffected by the error unless the party seeking to invalidate it can establish that a "reasonable person is likely to be misled materially by the error".

The legislative history of the curative provision reveals that the "reasonable person" test is intended to be objective. Limiting the attributes of the "reasonable person" to the effect of the error on the party challenging the security is to impose a personal or subjective test peculiar to the party. Such an interpretation substitutes a test based on actual prejudice for the reasonable person standard. That subjective approach cannot be used when the legislature intended an objective one. To do so is to resurrect under the guise of statutory interpretation a standard that the legislative history of the provision reveals was clearly rejected by the legislature. Those cases that used a subjective approach are aligned with an approach the legislature rejected.

An inquiry using the objective standard of the "reasonable person" cannot focus on a particular party, but must look to the broader class of persons who may have cause to use the search facilities of the registration system. In doing so, one must determine, not the existence of actual prejudice, but the probability of some member of the class of persons being materially misled by the error. The concrete formulation of such a test must look to the purpose of s. 46(4) which is to preserve the integrity of the registration system provided by the Act. The system has two constituencies: those who register financing statements; and those who search the system for prior registrations. The integrity of the overall system must address the interests of both groups. The section should be interpreted, to the extent the language permits, so as to assign the burden of the error in a manner which best promotes the overall integrity of the system.

The purpose underlying the search function is particularly important to the interpretation of s. 46(4). A "reasonable person" is a person using the search facilities of the registration system for its intended purpose, which is to provide information to prospective buyers and lenders who are purchasing or taking personal property as collateral for a loan. The system may be used for other purposes by the commercial world, such as obtaining creditworthiness information; the protection of

the P.P.S.A. should not extend to such incidental uses. A "reasonable person" must also be regarded as a reasonably competent user of the system, who knows that potential security interests in motor vehicles, the targeted property, may be retrieved through two discrete searches of the system, one using the name of the debtor from the individual debtor name lines on the financing statement, the other using the VIN.

A debtor name search only might not locate all prior encumbrances for a motor vehicle. A VIN search only might not locate all prior encumbrances if the motor vehicle was not classified as consumer goods in a prior transaction. A reasonable user would increase the probability of recovering all prior encumbrances by using both searches. One search accesses financing statements by collateral identification through the VIN; the other accesses financing statements by debtor name rather than type of collateral. Fixed with that knowledge, a reasonable person, as a prospective searcher or lender, would realize the importance of the VIN search and perform such a search. Therefore, when the collateral is a motor vehicle, a reasonable person must perform both the VIN and specific debtor name searches. For motor vehicles the integrity of the registration system is not name-dependent.

A reasonable person is not "likely to be misled materially" when a financing statement contains errors in the debtor's name, but has a correct VIN. Since the financing statement would be revealed by a VIN search, which a reasonable person would perform, a reasonable person would thereby be put on notice of the existence of the security interest referred to in the financing statement and could proceed accordingly. In such a case, judicial discretion ought to be used to cure the defects in the debtor's name, and the financing statement should be held to fall within the requirements of the regulations; the security interest should thus be held to be perfected. A perfected security interest has priority over the claim of the trustee. (Note that the case would be different if the financing statement contained errors in a debtor's name and did not contain a VIN, or if the debtor's name was accurate, but the VIN was erroneous.)

Cases considered

Adelaide Capital Corp. v. Integrated Transportion Finance Inc. (1994), 6 P.P.S.A.C. (2d) 267, 16 O.R. (3d) 414, 23 C.B.R. (3d) 289, 111 D.L.R. (4th) 493 (Gen. Div. [Commercial List]) – considered.

Armstrong, Thomson & Tubman Leasing Ltd. v. McGill Agency Inc. (Trustee of) (1993), 5 P.P.S.A.C. (2d) 231, 15 O.R. (3d) 292, 21 C.B.R. (3d) 295 (Bktcy.) – considered.

Bellini Manufacturing & Importing Ltd., Re (1981), 1 P.P.S.A.C. 259, 32 O.R. (2d) 684, 14 B.L.R. 63, 37 C.B.R. (N.S.) 209, 122 D.L.R. (3d) 472 (C.A.) – referred to.

Canamsucco Road House Food Co. v. Lngas Ltd. (1991), 2 P.P.S.A.C. (2d) 203 (Ont. Gen. Div.) – overruled.

Charles, Re (1990), 9 P.P.S.A.C. 280, 73 O.R. (2d) 245, 79 C.B.R. (N.S.) 92, 71 D.L.R. (4th) 181, 40 O.A.C. 114 (C.A.) – approved.

Ford Credit Canada Ltd. v. Percival Mercury Sales Ltd. (1986), 6 P.P.S.A.C. 288, [1986] 6 W.W.R. 569, 50 Sask. R. 268 (C.A.) [additional reasons at (1986), 50 Sask. R. 270 (C.A.)] – referred to.

Fritz (Trustee of) v. Ford Credit Canada Ltd. (1992), 4 P.P.S.A.C. (2d) 143, 15 C.B.R. (3d) 311 (Ont. Bktcy.) – overruled.

General Motors Acceptance Corp. of Canada v. Stetsko (1992), 3 P.P.S.A.C. (2d) 79, (sub nom. *General Motors Acceptance Corp. of Canada v. Northway (Trustee of)*) 8 O.R. (3d) 537 (Gen. Div.) – overruled.

Ghilzon, Re (1993), 5 P.P.S.A.C. (2d) 49, 21 C.B.R. (3d) 71 (Ont. Bktcy.) – applied in part.

Haasen, Re (1992), 3 P.P.S.A.C. (2d) 250, 8 O.R. (3d) 489, 13 C.B.R. (3d) 94, 92 D.L.R. (4th) 204 (Bktcy.) [reversed (1994), 7 P.P.S.A.C. (2d) 262 (Ont. C.A.)] – overruled.

Kelln (Trustee of) v. Strasbourg Credit Union Ltd. (1992), 3 P.P.S.A.C. (2d) 44, 9 C.B.R. (3d) 144, [1992] 3 W.W.R. 310, 89 D.L.R. (4th) 427, (sub nom. *Kelln, Re*) 100 Sask. R. 164, 18 W.A.C. 164 (C.A.) – distinguished in part.

Millman, Re (1994), 6 P.P.S.A.C. (2d) 244, 17 O.R. (3d) 653, 24 C.B.R. (3d) 190 (Ont. Bktcy.) – applied.

Prenor Trust Co. of Canada v. 652729 Ontario Ltd. (1992), 4 P.P.S.A.C. (2d) 139 (Ont. Gen. Div.) – overruled.

Rose, Re (1993), 6 P.P.S.A.C. (2d) 53, 23 C.B.R. (3d) 58, 16 O.R. (3d) 360, 110 D.L.R. (4th) 86 (Ont. Bktcy.) – overruled.

Weber, Re (1990), 1 P.P.S.A.C. (2d) 36, 73 O.R. (2d) 238, 48 B.L.R. 1, 78 C.B.R. (N.S.) 224 (Bktcy.) – distinguished.

Woolf, Re (1992), 7 P.P.S.A.C. (2d) 268 at 270, 15 C.B.R. (3d) 292 (Ont. Bktcy.) [reversed (1994), 7 P.P.S.A.C. (2d) 268 at 276 (Ont. C.A.)] – overruled.

656956 Ontario Ltd. v. General Electric Capital Equipment Finance Inc. (1992), 3 P.P.S.A.C. (2d) 207, 8 O.R. (3d) 481, 90 D.L.R. (4th) 76, 55 O.A.C. 172 (Div. Ct.) – referred to.

Statutes considered

Personal Property Security Act, R.S.O. 1980, c. 375 –
s. 47(5)

Personal Property Security Act, R.S.O. 1990, c. P.10 –
s. 9(2)
s. 19(b)
s. 20(1)(b)
s. 23
s. 28(1)
s. 45
s. 46(2) [rep. & sub. 1991, c. 44, s. 7(3)]
s. 46(4)

Personal Property Security Act, S.S. 1979-80, c. P-6.1 –
s. 66(1)

Regulations considered

Personal Property Security Act, R.S.O. 1990, c. P-10 –
O. Reg. 372/89 [now R.R.O. 1990, Reg. 912],
s. 3(7)
s. 3(8)
s. 3(9)
s. 16(1)

Authorities considered

McLaren, Richard H., *Secured Transactions in Personal Property in Canada*, 2nd ed. (Toronto: Carswell, 1989 looseleaf) – §30.01[1], §30.02[4][a].

Personal Property Security Act Enquiry Guide (Toronto: Ministry of Consumer and Commercial Relations, 1993) – pp. 70-71.

Report of the Minister's Advisory Committee on the Personal Property Security Act (Toronto, 1984) – pp. 13, 27-28.

Zeigel, Jacob S., "The New Provincial Chattel Security Law Regimes" (1991), 70

Can. Bar Rev. 681 – pp. 715-16.
Zeigel, Jacob S., "Personal Property Security Legislative Activity, 1986-1988" (1989), 15 *Can. Bus. L.J.* 108 – pp. 112-15.
Zeigel, Jacob S., "Protecting the Integrity of the Ontario Personal Property Security Act" (1987-1988), 13 *Can. Bus. L.J.* 359 – p. 368.
Zeigel, Jacob S., and Denomme, *The Ontario Personal Property Security Act: Commentary and Analysis* (Toronto: Canada Law Book, 1994) – pp. 361-62, 364-65.

Canadian Abridgment (2nd) Classification
Personal Property Security
III.1.e.ii.
Personal Property Security
III.1.e.v.

APPEAL from a decision of Farley J. (1992), 2 P.P.S.A.C. (2d) 160, 11 C.B.R. (3d) 165 (Ont. Bktcy.), disallowing the secured creditor's claim for a perfected security interest.

Edward M. Hyer, for General Motors Acceptance Corporation of Canada Limited, appellant.
Rosemary Fisher-Cobb, for trustee in bankruptcy, respondent.

(Doc. CA C8364)

September 29, 1994. The judgment of the court was delivered by

DOHERTY J.A.: –

1. *The Issue*[*]

1 When will an error in the contents of a financing statement render the statement invalid and the security interest it represents unperfected as against third parties? The answer depends on the reach of s. 46(4) of the *Personal Property Security Act*, R.S.O. 1990, c. P.10 ("P.P.S.A.") which reads:

> (4) A financing statement or financing change statement is not invalidated nor is its effect impaired by reason only of an error or omission therein or in its execution or registration unless a reasonable

[*]The same issue was raised in *Re Woolf* (File #C13753), *Re Tanzer* (File #C13690) and *Re Haasen* (File #C12153). The appeals were heard together and these reasons reflect the arguments advanced in all four cases. [These three cases are reproduced following this judgment.]

person is likely to be misled materially by the error or omission.

II. *The Facts*

2 Mr. Lambert purchased a motor vehicle under the terms of a conditional sales contract. The vendor sold the contract to the appellant ("GMAC"). GMAC registered its security interest in the vehicle by filing a financing statement as provided in the P.P.S.A. The financing statement referred to the debtor as "Gilles J. Lambert". This was the name used by Mr. Lambert when he signed the conditional sales contract and was also the name used to identify the owner of the vehicle in the records of the Ministry of Transportation and Communication. Unfortunately, it is not Mr. Lambert's proper name. His name, as shown on his birth certificate, is Joseph Phillipe Gilles Lambert. The financing statement correctly identified Mr. Lambert's date of birth and correctly set out the vehicle identification number (the "VIN").

3 Subsequent to the registration, Mr. Lambert made an assignment in bankruptcy and his trustee took possession of the motor vehicle. GMAC filed a proof of claim contending that it was a secured creditor with a security interest in the motor vehicle. At some point subsequent to the assignment in bankruptcy, the trustee acquired a copy of the GMAC financing statement. It identified the vehicle as "consumer goods".

4 The trustee caused its solicitor to inquire into the claim of GMAC. To do so, she turned to the computerized registration system established under the P.P.S.A. That system made three inquiries available. A searcher could conduct an individual specific debtor name inquiry (a specific debtor inquiry), an individual non-specific debtor name inquiry (a non-specific debtor inquiry) and a vehicle number inquiry (a VIN search). To conduct the specific debtor inquiry, a searcher must enter into the computer the debtor's first name, middle initial, last name and date of birth. This search retrieves only financing statements in which the debtor's first name, middle initial, last name and date of birth as set out in the financing statement exactly match the data entered by the searcher. The non-specific inquiry requires the searcher to enter the debtor's first and last name. It reveals all financing statements where the debtor is described by that first and last name regardless of the middle initial, if any, or the date of birth shown in the financing statement. A VIN search is made by entering the VIN only and retrieves all financing statements in which the collateral is described by the same VIN entered by the searcher

regardless of the name of the debtor.[1] The VIN search is available only where the collateral is a motor vehicle. The VIN must be recorded in the financing statement where the motor vehicle is classified as consumer goods. Where the motor vehicle is not so classified, the VIN may be included in the financing statement.

5 The trustee's solicitor, relying on the name on Lambert's birth certificate, made individual specific inquiries using the names "Joseph P. Lambert" and "Joseph G. Lambert" and Lambert's birthdate. She also made an individual non-specific search using the name "Joseph Lambert". None of these searches revealed the financing statement filed by GMAC since it referred to the debtor as Gilles J. Lambert. The solicitor did not conduct a VIN search, although the trustee had access to that number. A VIN search would have revealed the GMAC financing statement.

6 The trustee moved for a declaration that the GMAC security interest was not perfected and was, therefore, not effective against the trustee in bankruptcy. The trustee submitted that the errors in the recording of the debtor's name in the financing statement were fatal to the perfection of that interest as against the trustee. GMAC maintained that the errors were cured by s. 46(4) of the P.P.S.A. since the trustee should have performed a VIN search and, had he done so, he would not have been misled by the errors in the debtor's name. Farley J. found in favour of the trustee. His reasons are now reported at (1991), 2 P.P.S.A.C. (2d) 160 (Ont. Bktcy.)

III. *Analysis*

7 But for s. 46(4), there would be little difficulty applying the terms of the P.P.S.A. to this fact situation.

8 Section 19(b) of the P.P.S.A. provides that a security interest is perfected when all steps required for perfection under the P.P.S.A. have been completed. Section 23 of the P.P.S.A. declares that registration perfects the security interest in all types of collateral. Perfection by registration requires the registering of a financing statement (s. 45). The financing statement must be in the prescribed form (s. 46(2)). The prescribed form is set out in O. Reg. 372/89 (now R.R.O. 1990, Reg. 912). Section 16 of that regulation provides:

> 16.(1) The name of a debtor who is a natural person shall be set out in the financing statement to show the first given name, followed

[1] The searcher may also request additional registrations containing similar VIN numbers: *Personal Property Security Act Enquiry Guide* (Minister of Consumer and Commercial Relations, 1993) at pp. 70-71.

> by the initial of the second given name, if any, followed by the surname.

9 Sections 3(7), (8) and (9) of the same regulation are also relevant:

> (7) If the collateral includes a motor vehicle and the motor vehicle is classified as consumer goods, the motor vehicle shall be described on line 11 or 12 on the financing statement or in the appropriate place on a motor vehicle schedule.
>
> (8) If the collateral includes a motor vehicle and the motor vehicle is not classified as consumer goods, the motor vehicle may be described on line 11 or 12 on the financing statement or in the appropriate place on a motor vehicle schedule.
>
> (9) The description of the motor vehicle on line 11 or 12 or on a motor vehicle schedule shall include the vehicle identification number, the last two digits of the model year, if any, the model, if any, and the make or the name of the manufacturer.

10 GMAC's financing statement complied with the relevant parts of s. 3 of the regulation, but did not comply with s. 16 in that it incorrectly stated both Lambert's first name and his middle initial. Accordingly, GMAC's financing statement was not in the prescribed form and but for the possible effect of s. 46(4) of the P.P.S.A., GMAC's security interest in the vehicle was not perfected.

11 Section 20(1)(b) of the P.P.S.A. declares that an unperfected security interest in any collateral is not effective against a trustee in bankruptcy. Again, setting aside s. 46(4) of the P.P.S.A., it would follow that since GMAC's security interest was not registered in accordance with the Act and hence not perfected, it was ineffective as against the trustee in bankruptcy. But for s. 46(4) of the P.P.S.A., the trustee was entitled to the declaration made by Farley J.

12 Does s. 46(4) of the P.P.S.A. alter this result? For convenience, I will repeat the section:

> (4) A financing statement or financing change statement is not invalidated nor is its effect impaired by reason only of an error or omission therein or in its execution or registration unless a reasonable person is likely to be misled materially by the error or omission.

13 Two features of s. 46(4) are non-controversial. First, it is potentially applicable to any error in a financing statement: *Re Weber* (1990), 1 P.P.S.A.C. (2d) 36 at 40, 78 C.B.R. (N.S.) 224 at 227 (Ont. Bktcy.). Secondly, an error in a financing statement does not *per se* invalidate that statement or impair the security interest claimed by the statement. The validity of the financing statement is unaffected by the error unless the party seeking to invalidate the financing statement

demonstrates that "a reasonable person is likely to be misled materially by the error".

14 Interpreting s. 46(4) becomes more difficult once one ventures beyond these two propositions. Some trial courts in this province have approached s. 46(4) by looking to the effect of the error in the financing statement on the party challenging the security. Cases taking that view include: *Fritz (Trustee of) v. Ford Credit Canada Ltd.* (1992), 4 P.P.S.A.C. (2d) 143 at 146, 15 C.B.R. (3d) 311 at 314 (Ont. Gen. Div.); *Prenor Trust Co. of Canada v. 652729 Ontario Ltd.* (1992), 4 P.P.S.A.C. (2d) 139 at 141-42 (Ont. Gen. Div.); *Canamsucco Road House Food Co. v. Lngas Ltd.* (1991), 2 P.P.S.A.C. (2d) 203 at 208 (Ont. Gen. Div.); *General Motors Acceptance Corp. of Canada v. Stetsko* (1992), 3 P.P.S.A.C. (2d) 79 at 83-84, 8 O.R. (3d) 537 at 541-42 (Ont. Gen. Div.); *Re Rose* (1993), 6 P.P.S.A.C. (2d) 53, 16 O.R. (3d) 360 (Bktcy.).

15 In *Fritz, supra*, the debtor's name had been incorrectly spelled on the financing statement, but the VIN was accurately recorded. The trustee performed only a specific debtor inquiry. That inquiry did not retrieve the financing statement. A VIN search would have located the financing statement. The trustee had been told by the debtor that the automobile in question was pledged to the creditor. Chadwick J. found that the mistake in the debtor's name constituted an error in the financing statement. He then turned to s. 46(4) of the P.P.S.A. In holding that the creditor had a valid security interest, Chadwick J. said at p. 314 [C.B.R., p. 146 P.P.S.A.C.]:

> The "reasonable person" that is referred to in considering s. 46(4) is not an imaginary person but the person who is challenging the validity of the security agreement. In this case, the trustee in bankruptcy had actual notice of the interests of Ford Credit Canada Limited at the time of the assignment in bankruptcy. He was informed by the bankrupt that the 1989 Ford Tempo was fully secured by Ford Canada Limited. The name search under the P.P.S.A. by the trustee was only for the purpose of determining whether there were any errors in the registration of the documentation and not for the purpose of a *bona fide* purchaser.
>
> It is obvious from the facts in this case that the trustee was not materially misled as a result of the incorrect registration.

16 In *Stetsko, supra*, a creditor placed the wrong birthdate of the debtor in the financing statement. The trustee was told by the debtor of the creditor's secured interest in the automobile, but he conducted only a specific debtor inquiry. That inquiry did not retrieve the creditor's financing statement because of the error in the birthdate. In holding that the creditor's interest remained perfected as against the trustee Maloney J. referred, with approval, to the analysis of s. 46(4) found in *Canamsucco*, and said at p. 542 [O.R., p. 84 P.P.S.A.C.]:

> . . . in trying to determine whether the "reasonable person" is likely to be misled one can only look to: (1) who that person is, (2) what knowledge he may have had, and (3) how he may be affected by it.

17 On this view of s. 46(4), the error in the financing statement is of no consequence if the party challenging the statement had knowledge of the security interest, or if that party acting reasonably, given its knowledge, could have located the financing statement using the various searches available under the P.P.S.A. This approach has some attraction, especially in cases where the trustee in bankruptcy is seeking to take advantage of an error in the financing statement. In those cases, the trustee appears more as an opportunist pouncing on a windfall than as a vulnerable prospective creditor or purchaser seeking the protection of reliable registration system: Zeigel, "The New Provincial Chattel Security Law Regimes" (1991), 70 *Can. Bar Rev.* 681, at pp. 715-16. The subjective approach may be said to do "justice" in cases involving the trustee in bankruptcy in that it denies the trustee the windfall.

18 I cannot, however, agree with this interpretation of s. 46(4). By using the "reasonable person" standard, the legislature intended that the test provided in s. 46(4) should be an objective one. To limit the inquiry to the effect of the error on the party challenging the security is to impose a personal or subjective test peculiar to that party. Furthermore, this interpretation substitutes a test based on actual prejudice for the reasonable person standard set out in the section. As written, s. 46(4) does not require evidence that the error actually misled any person.

19 The language of s. 46(4) may be usefully compared to that found in s. 9(2) of the P.P.S.A.:

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

20 Section 9(2) expressly declares that a security agreement is not unenforceable by virtue of an error in that agreement unless "the third party is actually misled by the . . . error". The language of s. 46(4) which specifically targets financing statements stands in marked contrast to the subjective language of s. 9(2). The approach taken in *Fritz, supra, Stetsko, supra*, and similar cases is appropriate to the language of s. 9(2), but not to the very different language found in s. 46(4).

21 The statutory history of s. 46(4) is also informative on this point. I need not detail that history as it is fully chronicled

elsewhere.[2] It is sufficient for my purposes to observe that s. 47(5) of the P.P.S.A., R.S.O. 1980, c. 375, the predecessor section of 46(4), set out an actual prejudice test as part of its scheme for distinguishing between errors in financing statements which invalidated the statement and those which did not: *Re Charles* (1990), 9 P.P.S.A.C. 280 at 284, 73 O.R. (2d) 245 at 249 (C.A.). In 1984, the Minister's Advisory Committee on the *Personal Property Security Act* (the Catzman Committee) recommended that the curative provisions in the Act be amended to provide for a reasonable person standard in evaluating the effect of errors in financing statements and security agreements: Ontario, *Report of the Minister's Advisory Committee on the Personal Property Security Act*, 1984 at pp. 13, 27-28. A similar recommendation was made by the committee in 1986, although that recommendation was limited to financing statements. The recommendation of the committee was opposed by those who preferred a subjective, actual prejudice test. At first it appeared that the government of the day would support the subjective approach. An early draft of the proposed amendments to the P.P.S.A. included the following:[3]

> A financing statement . . . is not invalidated nor is its effect impaired by reason only of a defect, irregularity, omission or error therein or in the execution or registration thereof unless the defect, irregularity, omission or error has actually misled someone.[3]

22 However, the Bill as eventually introduced adopted the committee's recommendation. That recommendation proposed a curative proviso in the same words as are now found in s. 46(4).

23 The genealogy of s. 46(4) is remarkably complete. There is no need to speculate about how the section ended up as it did. Two competing approaches were put forward and their respective merits debated over several years. In the end, a standard determined by reference to the probability of a reasonable person being materially misled won out over the subjective actual prejudice test favoured by others. With respect, the approach to s. 46(4) taken in *Fritz, Stetsko* and similar cases is closely aligned to the approach the legislature considered and rejected when it opted for the language of s. 46(4). Whatever the merits of the arguments in favour of an actual prejudice test, those arguments were made before the appropriate forum and

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[2]Zeigel, "Protecting the Integrity of The Ontario Personal Property Security Act" (1987-88), 13 *Can. Bus. L.J.* 359; Zeigel, "Personal Property Security Legislative Activity, 1986-88" (1989), 15 *Can. Bus. L.J.* 108, at pp. 112-15.

[3]Reproduced in Zeigel, "Protecting The Integrity of The Ontario Personal Property Security Act", *supra*, n. 2, at p. 368.

found wanting. They cannot be resurrected under the guise of statutory interpretation.

24 Support for the conclusion that the reasonable person referred to in s. 46(4) cannot be equated with a person in the position of the party seeking to invalidate the financing statement is found in *Kelln (Trustee of) v. Strasbourg Credit Union Ltd.* (1992), 3 P.P.S.A.C. (2d) 44, 89 D.L.R. (4th) 427 (Sask. C.A.). Section 66(1) of the P.P.S.A., S.S. 1979-80, c. P-6.1 provides:

> 66.(1) The validity or effectiveness of a document to which this Act applies is not affected by reason of a defect, irregularity, omission or error therein or in the execution or registration thereof unless the defect, irregularity, omission or error is seriously misleading.

25 This section applies to financing statements registered under the Saskatchewan Act. If anything, the language of s. 66(1), which does not contain any specific reference to the reasonable person, is more susceptible to the subjective actual prejudice approach than is s. 46(4) of the P.P.S.A. Despite that arguable ambiguity, the Saskatchewan Court of Appeal unanimously held that s. 66(1) sets out a purely objective test. The court specifically rejected trial decisions in Saskatchewan which had considered the effect of the error from the vantage point of the party challenging the validity of the financing statement. Bayda C.J.S. at p. 430 [D.L.R.; p. 60 P.P.S.A.C.], speaking only for himself, held that the application of the curative proviso was to be determined by asking:

> . . . whether a reasonable person using registration and search systems put in place by the Act is apt by reason of the omission and the circumstances surrounding it to end up believing that something important is so when in fact it is not so.

26 Vancise J.A. at p. 442 [D.L.R.; p. 57 P.P.S.A.C.], writing for himself and Wakeling J.A., adopted the question posed by Professor Cuming as the appropriate approach:

> "Would the defect, irregularity, omission or error be seriously misleading to any reasonable person within the class of person for whose benefit registration or other methods of perfection are required?"

27 Trial courts in this province, including Farley J. in this case, have also rejected the approach taken in *Fritz* and *Stetsko* in favour of one which looks to the hypothetical users of the search facilities provided by the registration system. These cases include: *Armstrong, Thomson & Tubman Leasing Ltd. v. McGill Agency Inc. (Trustee of)* (1993), 5 P.P.S.A.C. (2d) 231 at 237-39, 15 O.R. (3d) 292 at 297-98 (Bktcy.); *Re Haasen* (1992), 3 P.P.S.A.C. (2d) 250 at 262, 8 O.R. (3d) 489 at 499 (Bktcy.); *Re Ghilzon* (1993), 5 P.P.S.A.C. (2d) 49 at 51-52, 21 C.B.R. (3d) 71 at 73-74 (Ont. Bktcy.); *Re Weber, supra*, at p. 41-42

P.P.S.A.C., p. 243 C.B.R.; *Re Woolf* (1992), 7 P.P.S.A.C. (2d) 268 at 274-76, 15 C.B.R. (3d) 292 at 298-300 (Ont. Bktcy.); *Adelaide Capital Corp. v. Integrated Transportion Finance Inc.* (1994), 6 P.P.S.A.C. (2d) 267 at 282-83, 16 O.R. (3d) 414 at 428-29 (Gen. Div. [Commercial List]). *Weber* was cited with approval by the Divisional Court in *656956 Ontario Ltd. v. General Electric Capital Equipment Finance Inc.* (1992), 3 P.P.S.A.C. (2d) 207 at 211-12, 8 O.R. (3d) 481 at 485-86 (Div. Ct.).

28 Professor Ziegal and Mr. Denomme in their recent text, *The Ontario Personal Property Security Act: Commentary and Analysis* (1994) also favour the objective approach to s. 46(4). After a comparison of the present section and its predecessor, they write at pp. 361-62:

> As noted, s. 46(4) implements an objective test – would "a reasonable person" be "misled materially" by the error or omission? If the question is answered "yes", it matters not whether the party attacking the erroneous statement, or indeed anyone else, was actually misled. The reason for the use of such a test is to maintain the integrity of the registration system and to avoid costly litigation; registrants must have such a test in mind and attempt always to complete registrations so that no reasonable person could be so misled. If they fail to do so, it will not matter that, fortuitously, no one can be found who actually reviewed and relied upon the erroneous portion of the statement. This will provide an incentive to registrants to ensure that registrations are correct and complete and will result in a more reliable and useful system.
>
> A continuing problem in the jurisprudence in this area is the tendency to render fact-specific decisions which, while seeming to be more fair in the particular case, introduce uncertainties which serve to weaken the structure and purpose of the registration system. There is an understandable reluctance to deprive secured parties of perfected security interest for what seem like minor and technical errors in financing statements or financing change statements. This has led some courts to seek to do justice as between a registrant and a party challenging the registration by finding that the challenger has not been prejudiced by the error. It bears repeating that the plain words of s. 46(4) require an objective enquiry into whether "a reasonable person is likely to be misled materially" by the defect in question.

29 Later, after a consideration of *Kelln, supra*, and the conflicting authority in Ontario, the authors conclude at pp. 364-65:

> With respect to registration errors, the initial question posed by the statute is "would a reasonable person have been misled materially by this error?" The answer to this question cannot depend on the facts of a particular case – to allow it to do so leads to random results. The registration process, insofar as it is under the control of the registrant, should be very carefully monitored for errors because it is not pos-

> sible to predict, at the date of registration, who may later access the information or for what purpose. Therefore, to the extent an onus should be placed on anyone it should be placed on the registrant in order to preserve the reliability of the registration system.

30 Without adopting the ultimate conclusions reached in *Kelln* and the supporting Ontario authorities, or all of the reasons put forward by Ziegel and Denomme in support of their position, I do agree that s. 46(4) sets out an objective test. The inquiry dictated by s. 46(4) cannot focus on a particular party, but must look to the broader class of persons who may have cause to use the search facilities of the registration system. In looking to that broader class of person, one must determine, not the existence of actual prejudice, but the probability of some member of that class of persons being materially misled by the error. As s. 46(4) lays down an objective test, a party challenging the security on the basis of errors in the financing statement need not demonstrate actual prejudice to that party or anyone else. The trustee in bankruptcy may rely on an error in a financing statement to invalidate a secured interest claimed in that statement if the trustee or other third party can show that the error in the financing statement was likely to materially mislead a reasonable person.

31 My conclusion that s. 46(4) creates an objective test which requires an assessment of the error's impact on those persons who might use the search facilities of the registration system does not resolve this appeal. It remains to provide a concrete formulation of that test.

32 I begin with the purpose of s. 46(4). The section is designed to preserve the integrity of the registration system provided by the P.P.S.A. That system has two constituencies: those who register financing statements; and those who search the system for prior registrations. The integrity of the overall system must address the interests of both groups. Section 46(4) seeks to maintain the system's integrity by distributing the impact of errors, no matter how unavoidable, made in financing statements between the two groups. An interpretation of s. 46(4) which is too forgiving of such errors places too much of the burden on prospective creditors and purchasers (searchers). An interpretation which is too unforgiving of those errors places too much of the burden on creditors (registrants). In either event, the integrity of the registration system suffers. Section 46(4) should be interpreted, to the extent that its language permits, so as to assign the burden of the error in a manner which best promotes the overall integrity of the system.

33 I turn next to the context in which s. 46(4) exists. Its reach and limitations can be understood only in the framework of the registration system established under the P.P.S.A. and the purposes for which that system is used. Professor McLaren, in his text, *Secured Transactions in Personal Property in Canada*, 2nd ed. (1992), at

p. 30-2 [§30.01[1]] provides a succinct description of the purposes of the system:

> The personal property security registration system provides the vehicle to permit registration of a security interest and a non-possessory repair or storage lien. *It also provides information about the transaction and a means whereby a person who is intending to purchase personal property or to lend money on the security of personal property can determine whether the owner has granted a security interest in the property as security for a debt.* This informational function is accomplished by providing a mechanism by which a search of registrations under the Act may be made.
>
> The purpose of the registration system is to provide enough information to enable a person searching the system to know whom to contact to obtain information regarding a secured transaction. It is for this reason that the registration system is referred to as a notice-filing system. . . . [Emphasis added.]

34 The purpose underlying the search function of the registration system is particularly important to the interpretation of s. 46(4). As Professor McLaren properly points out, the inquiry or search function exists to provide information to prospective buyers and lenders who are purchasing property or taking property as collateral for a loan. The putative purchaser or lender wants to know whether there are any prior claims on the property which could affect the decision to buy the property or accept it as collateral.

35 In my view, the "reasonable person" in s. 46(4) is a person using the search facilities of the registration system for their intended purpose, that is, to find out whether personal property to be purchased or taken as collateral is subject to prior registered encumbrances. To assess the potential effect of an error in a financing statement one must assume that the property which is the subject of the flawed financing statement is the property targeted by the inquiry made by the prospective purchaser or lender. In this case, therefore, the question becomes – would a potential purchaser of the motor vehicle referred to in the financing statement, or a person considering taking that motor vehicle as security be materially misled by the error in a previously registered financing statement?[4] This articulation of the test accords with the purpose of the inquiry function of the system, and gives meaning to the requirement that the error be "likely to mislead materially". Unless the effect of the error is addressed in the con-

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[4]Apart from the protection afforded by the registration system, purchasers who buy from dealers are protected by s. 28(1) of the P.P.S.A.; see McLaren, *supra*, at p. 30-18.2 [§30.02[4][a]].

text of a potential purchase or loan involving the property specified in the financing statement, I am unable to see how an error in that financing statement could be "likely to materially mislead" a prospective purchaser or lender.

36 In so describing the purpose of the search function of the system, I am not unaware that it has other uses in the commercial world. Some potential creditors may do a P.P.S.A. search as part of their inquiry into the creditworthiness of a potential borrower. Those creditors will not be interested in the status of any particular property, but will be looking for any information that may assist in assessing the potential borrower's overall debt situation and creditworthiness. In describing the reasonable person for the purposes of s. 46(4), I would distinguish between a use to which the P.P.S.A. system can be put and the purpose for which the system exists. The system was not designed as a credit inquiry service, although it can provide information which will assist in determining creditworthiness. That same incidental use exists with respect to information stored in various other data banks established for a myriad of other purposes.

37 The preservation of the integrity of the P.P.S.A. registration system requires that those who use the system for its intended purpose be protected from errors made by other users where those errors are likely to misled materially. In my view, the same protection should not be extended to those who put the system to some different use which, while commercially beneficial, is not the purpose for the system. In my view, the reasonable person in s. 46(4) is not the person using the search facility as part of a general inquiry into a prospective borrower's creditworthiness.

38 The "reasonable person" using the inquiry function of the registration system for the purpose described above must also be regarded as a person who is familiar with the search facilities provided by the system. That is not to say that the standard is that of the most sophisticated and skilled user. The standard must be that of a reasonably competent user of the system: *Re Millman* (1994), 6 P.P.S.A.C. (2d) 244, 17 O.R. (3d) 653 (Gen. Div.). That reasonable user would be aware of the various searches available in the system and the product produced by each. Furthermore, the reasonable user must be taken to know that potential security interests in motor vehicles may be retrieved through two discrete searches of the system, one using the name of the debtor and the other the motor vehicle's VIN.

39 Having identified the reasonable person in s. 46(4) as a potential purchaser or lender seeking to locate prior encumbrances on the targeted property, and as a reasonably competent user of the search function of the registration system, I turn now to the information which that reasonable person could be expected to have when making his or her inquiry. No one suggests that the reasonable person would not be

able to get the name and birthdate of the vendor or borrower through the relevant records. Clearly, he or she would be able to obtain that information: *Re Haasen*, *supra*, at p. 500 [O.R., p. 262 P.P.S.A.C.]. The reasonable person as a potential purchaser or lender would not, however, necessarily have access to the names and birthdates of prior owners of the motor vehicle. These prior owners may have encumbered the vehicle. Financing statements giving notice of those encumbrances will be registered under the name of the prior owner and perhaps under the VIN.

40 In my opinion, the potential purchaser or lender acting reasonably would also obtain the VIN of the motor vehicle. He or she would be in a position to require access to the motor vehicle as a condition of the purchase or loan. Access to the motor vehicle means access to the VIN since it is found on a plate attached to the vehicle's dashboard. Furthermore, a reasonably prudent purchaser or lender familiar with the registration system would appreciate that the VIN could be used to search for prior encumbrances on the vehicle, particularly those registered against prior owners of the vehicle whose identity was unknown to the potential purchaser or lender. Fixed with this knowledge, the reasonable person would realize the importance of the VIN and would take advantage of his or her position as a purchaser or lender to require access to the VIN.

41 Would the reasonable person, having access to the seller or borrower's name (and birthdate) and the VIN of the motor vehicle, use both sources of information to conduct two searches of the registration system? With respect to the contrary view, I have no doubt that a reasonable person in possession of the information needed to conduct the two searches would in fact conduct both searches. The reasonable person would want to know about any prior encumbrances registered against the motor vehicle and would take all reasonable steps to locate notice of any prior encumbrance in the system. As a reasonable user of the registration system, he or she would know that prior encumbrances for motor vehicles could be registered under the debtor's name, the VIN, or both. A name search might not locate all prior encumbrances. A VIN search might not locate all prior encumbranches if the motor vehicle was not classified as consumer goods for the purposes of a prior transaction. By performing the two searches, the reasonable user would increase the probability of recovering all prior encumbrances. The added protection would come at minimal cost.[5] Any reasonable user would spend the few dollars required for the added information and comfort provided by two inde-

[5]We were informed by counsel that each additional search costs $10.

pendent searches of the registration system.

42 Those who have held that the reasonable person in s. 46(4) would conduct only a specific debtor name search have emphasized the importance to the registration system of using the debtor's correct name in the financing statement. For example, Donnelly J. in *Re Ghilzon*, *supra*, said at p. 74 [C.B.R.; p. 52 P.P.S.A.C.]: "The integrity of the registration system is name-dependent". No doubt this observation is accurate with regard to personal property other than motor vehicles. But where motor vehicles are involved, the integrity of the registration system does not depend only on accurately recording the debtor's name in the financing statement. Indeed, the VIN search function exists specifically because a name-dependent system for motor vehicles would be inadequate and would leave potential purchasers and lenders vulnerable to encumbrances placed on the motor vehicle by prior owners of the motor vehicle. In the case of motor vehicles, the registration system is not name-dependent. Rather, it provides for identification of prior registrations by the combined access to the system afforded by name and VIN searches.

43 An approach to s. 46(4) which excludes errors in the debtor's name from those which are curable by s. 46(4) harks back to the language of the former curative proviso (s. 47(5)) which declared that only clerical errors or errors in immaterial or non-essential parts of the financing statement were curable under that provision: *Re Weber*, *supra*, at pp. 228-29 [C.B.R.; pp. 40-41 P.P.S.A.C.]. The debtor's name is clearly a material and essential part of the financing statement: *Re Bellini Manufacturing & Importing Ltd.* (1981), 1 P.P.S.A.C. 259 at 267-68, 32 O.R. (2d) 684 at 692-93 (C.A.). The present curative proviso does not, however, fix on the part of the financing statement in which the error occurred, but instead looks to the effect of the error on the reasonable person. The present provision may cure any error no matter where it occurs in the financing statement, if that error is not likely to mislead materially a reasonable person. An error may occur in a material part of the financing statement, but may not, in light of additional information, found in the same financing statement and available to the reasonable person, materially mislead that person. Case law under the prior provision identifying the materiality of the debtor's name to the financing statement does not assist in deciding whether the reasonable person referred to in the current section would conduct more than a specific debtor search.

44 Proponents of the single-search approach also rely on the absence of any requirement in the P.P.S.A. that more than one search be done: *Re Weber*, *supra*, at p. 228 [C.B.R.; p. 41 P.P.S.A.C.]. The P.P.S.A. does not require that any search be done. A search for prior registered interests is triggered by self-interest, not by any statutory obligation. The nature of the search to be expected from a reasonable

person reflects the extent to which a reasonable person would go to protect his or her interests. The absence of any statutory provision requiring one or more searches is of no consequence.

45 In summary, the reasonable person in s. 46(4) has the following attributes:

- He or she is a reasonably prudent prospective purchaser or lender who looks to the registration system of the P.P.S.A. to provide notice of any prior registered claims against the property he or she is proposing to buy or take as collateral for a loan.
- He or she is conversant with the search facilities provided by the registration system and is a reasonably competent user of those facilities.
- Where the property to be bought or taken as collateral is a motor vehicle, the reasonable person will obtain the name and birthdate of the seller/borrower as well as the VIN of the motor vehicle.
- Where the property is a motor vehicle, the reasonable person will conduct both a specific debtor name search and a VIN search.

46 Bearing this reasonable person in mind I move to the final question. Is that reasonable person "likely to be misled materially" by a financing statement which contained an error in the debtor's name, but accurately set out the VIN? The purpose for which the reasonable person uses the search function of the registration system provides the key to determining when it can be said that the reasonable person would be materially misled by an error in a financing statement. The reasonable person uses the system to find prior registered secured interests in the property in question. If the error in the financing statement results in the reasonable person not retrieving that financing statement from the system, then the reasonable person will probably be misled materially. If despite the error, the reasonable person as defined above will still retrieve the flawed financing statement from the system, then the error in the financing statement is not likely to mislead materially.

47 A reasonable person would not likely be misled materially by an error in a financing statement relating to the debtor's name if that same financing statement accurately set out the VIN. That financing statement would come to the attention of the reasonable person through a VIN search despite the error in the name. The reasonable person would, therefore, be put on notice of the security interest

referred to in the financing statement and could proceed accordingly. This conclusion accords with that reached in *Ford Credit Canada Ltd. v. Percival Mercury Sales Ltd.* (1986), 6 P.P.S.A.C. 288, [1986] 6 W.W.R. 569 (Sask. C.A.).

48 The result would be very different if the financing statement incorrectly set out the debtor's name and did not contain the VIN, as could be the case if the motor vehicle had not been classified as consumer goods for the purposes of the transaction giving rise to the financing statement. In that situation, the error in the debtor's name would be fatal since the reasonable person conducting both a specific debtor search and a VIN search could not locate the financing statement. That is, however, not this case. This financing statement did include the VIN, and the impact of the error in the debtor's name must be assessed in that light. It supports the purpose behind the registration system to hold that a creditor who includes information in the financing statement which potentially permits a subsequent searcher to locate the financing statement through two independent means is in a better position than a creditor who chooses to limit itself to the bare essentials required by the regulations.

49 My conclusion would also be different if the VIN was improperly recorded in the financing statement and the debtor's name was accurately set out. In that situation, a reasonable person could well be materially misled by the error in the financing statement. Consider this example. P agrees to purchase a car from V. The car had been previously owned by X who pledged it to Y. Y registered a financing statement correctly identifying X as the debtor, but incorrectly setting out the VIN of the motor vehicle. P, proceeding as I have held a reasonable purchaser would, conducts a specific debtor search in the name of V (his vendor) and a VIN search using the proper VIN. The two searches conducted by P would not reveal Y's financing statement, because of the error made by Y with respect to the VIN. This error would therefore, probably materially mislead P since it would leave him unaware of Y's claim to a prior security interest in the motor vehicle. My conclusion that an error in the VIN even when coupled with a correct identification of the debtor would not be curable under s. 46(4) is consistent with the result in *Kelln*, *supra*.

50 Further reference to *Kelln* is necessary. In that case, the VIN was improperly recorded in the relevant financing statement, but the debtor's name was accurately recorded. The court held that the error could not be cured by the Saskatchewan equivalent of s. 46(4) of the P.P.S.A. As indicated above, I agree with that result. Vancise J.A. went on to hold that an error in the debtor's name where the VIN was properly recorded would be equally fatal. In doing so, he appears to have rejected the same court's holding in *Ford Credit Canada Ltd.*,

supra. Vancise J.A. and I part company at this point.

51 Vancise J.A. observes at p. 443 [D.L.R.; p. 58 P.P.S.A.C.] that an error in a financing statement is not curable if that error would result in "the failure to properly register or retrieve the information from the register concerning the collateral". I agree with this comment, except I would limit the concern to the proper retrieval of the information.

52 Vancise J.A. goes on at pp. 443-44 [D.L.R.; p. 58 P.P.S.A.C.] to hold:

> Thus the conclusion is that the failure to include both of the mandatory registration-search criterion [sic] where it is required will result in the registration being seriously misleading and render the security interest unperfected.
>
> As noted, the reason for such objective interpretation is to provide a consistent approach to the registration and perfection of security interests.
>
> The failure to include the debtor's name on a financing statement where there is already a serial number which correctly describes the collateral should render the security interest unperfected. In other words, where there is a requirement for both criterion [sic] the failure to include one is seriously misleading and the failure to comply renders the registration invalid. If one or both of the mandatory registration-search criteria contain errors which do not prevent the proper identification or retrieval of the financing statement, the error is not seriously misleading and the security interest should be perfected.

53 This analysis proceeds on the basis that only a single search need be performed by the prospective purchaser or lender. Consequently, an error in either the name or the VIN which prevented a person conducting either, but not both of those searches from locating the financing statement would be materially misleading.

54 I reach a different result than Vancise J.A. because, for the reasons I have already set out, I proceed on the premise that the prospective purchaser or lender would have access to both the seller/borrower's name and the VIN, and would conduct both searches. An error in a financing statement would probably be materially misleading only if the error caused the financing statement to escape the net cast by the combined reach of both searches.

55 Vancise J.A. quite properly supports his approach on the basis of the certainty and predictability it achieves. My approach borrows from his, save for the different assessment of the searches a reasonable person would conduct, and achieves the same consistency and predictability. In my estimation, it also more effectively preserves the integrity of the registration system by more fairly balancing the inter-

ests of secured creditors and prospective purchasers and lenders. A creditor's secured interest should not fail as against third parties by virtue of an error in the financing statement, if that error would not preclude retrieval of the financing statement by a prospective purchaser or lender taking reasonable steps to protect his or her interest and making reasonable use of the search facilities provided by the registration system.

56 I would hold that the trustee has not established that the error in the GMAC financing statement would probably have misled materially a reasonable person. The financing statement is therefore not invalidated and GMAC's security interest in the motor vehicle is perfected.

IV. *The Order*

57 GMAC did not commence its appeal within the time period permitted by the statute. It was, however, out of time by only a few days and had formed the intention to appeal within the specified time period. The trustee does not allege any prejudice arising from the delay. I would grant the necessary extension of time for the service and filing of the notice of appeal. I would also allow the appeal, set aside the order of Farley J. and substitute an order declaring that, as against the trustee, GMAC has a perfected security interest in the motor vehicle.

58 GMAC is entitled to its costs both in this court and in proceedings before Farley J. Costs before Farley J. should be in the amount fixed by him.

Appeal allowed.

27 B.L.R. 247

1984 CarswellOnt 108

Misener Financial Corp. v. General Home Systems Ltd.

MISENER FINANCIAL CORPORATION v. GENERAL HOME SYSTEMS LTD. et al.

Ontario Supreme Court, High Court of Justice

Saunders J.

Heard: February 6, 1984

Judgment: August 14, 1984

Docket: No. 60820A/80

Counsel: E. Chaplick and J. Copelovici, for plaintiff.

P. Morrissey, for defendant General Home Systems Ltd.

Subject: Corporate and Commercial

Personal Property Security --- Disposition of collateral by debtor -- Sale in ordinary course of business.

Personal property security -- Manufacturer selling mobile home to dealer with title to remain in manufacturer until payment -- Security interest of manufacturer not registered under Personal Property Security Act, R.S.O. 1980, c. 375 -- Dealer selling mobile home to finance company who leased it to principal of dealer -- Finance company purchasing mobile home free of security interest of manufacturer.

G Ltd. was a manufacturer of mobile homes and sold several to R Ltd. which was a dealer in mobile homes. The mobile homes were shipped on the basis that they would not be disposed of in any manner until paid for and would be returned in 10 days if not paid for. The invoice provided that title to the property remained vested in G Ltd. until full payment. The security interest of G Ltd. in the mobile home was not registered under the Personal Property Security Act (Ontario) ("PPSA") and hence was unperfected. R Ltd. sold one of the mobile homes to M Ltd., a finance company which in turn leased it on the same day to M who was the principal of R Ltd. M Ltd. paid the purchase for the vehicle to R Ltd. 3 days later. M Ltd. was unaware of the security interest of G Ltd. or G Ltd.'s relationship with R Ltd.

The lease transaction enabled M to finance the acquisition of the vehicle and provided M Ltd. with rental income and deductible capital cost allowance for income tax purposes. The Court found that the lease was one intended as security within the meaning of the PPSA.

M Ltd. never took possession of the vehicle and it remained on the lot of R Ltd. G Ltd. repossessed the vehicle and sold it. M Ltd. registered a financing statement with respect to its lease under the PPSA one day after the seizure by G Ltd. M Ltd. brought an application to determine the priority of the security interests in the vehicle.

Held:

The security interest of M Ltd. had priority.

R Ltd. had sold the vehicle to M Ltd. in the ordinary course of business and as a result, M Ltd. took the vehicle free from the security interest of G Ltd. Although M Ltd. acquired the vehicle as part of a financing transaction and then leased it pursuant to a lease intended as security, it nevertheless was a purchase from a seller who sold the vehicle in the ordinary course and M Ltd. could take the benefit of s. 30 of the PPSA. The fact that R Ltd. knew that the vehicle was to be leased to its principal after the sale and that the sale and lease occurred on the same day did not take the sale out of the ordinary course.

Cases considered:

Banque Natioale de Paris (Can.) v. Pine Tree Mercury Sales Ltd. (1983), 42 O.R. (2d) 303, 47 C.B.R. (N.S.) 300, 3 P.P.S.A.C. 51 (Ont. Co. Ct.) -- referred to

Fairline Boats Ltd. v. Leger (1980), 1 P.P.S.A.C. 218 (Ont. H.C.) -- considered

Ford Motor Credit Co. of Can. Ltd. v. Centre Motors of Brampton Ltd. (1982), 38 O.R. (2d) 516, 2 P.P.S.A.C. 63, 137 D.L.R. (3d) 634 (Ont. H.C.) -- referred to

Nat. Trailer Convoy of Can. Ltd. v. Bank of Montreal (1980), 10 B.L.R. 196, 1 P.P.S.A.C. 87 (Ont. H.C.) -- referred to

Statutes considered:

Personal Property Security Act, R.S.O. 1980, c. 375, ss. 10, 30(1).

APPLICATION to determine priority of security interests in a mobile home.

***Saunders J.*:**

1 The issue in this action is one of priority under the Personal Property Security Act, R.S.O. 1980, c. 375 (the "PPSA") between the interest of the plaintiff Misener Financial Corporation, ("Misener") and the defendant General Home Systems Ltd. ("General") in a mobile home manufactured by General (the "vehicle").

2 In July, 1980, General sold the vehicle to the defendant 440026 Ontario Limited which carried on business as Rumble Leisure Products ("Rumble") for $30,334.

3 The defendant Norman Maxwell was an officer of Rumble and may have been its only director and shareholder. Maxwell had taken over from a previous dealer of General in January, 1980. In the following April, the dealership held by Maxwell was apparently assigned to Rumble.

4 In the usual course, sales by General to Rumble were financed through a Canadian chartered bank. The general manager of General testified at the trial that in July, 1980, Maxwell was negotiating arrangements with a new bank and with Misener. In anticipation of the new arrangements, Maxwell had requested General to deliver units to Rumble in order to implement the Misener transaction and to provide a display. The general manager testified that a number of units including the vehicle were shipped on the basis that they would not be disposed of in any manner until paid for and would be returned in ten days if not paid for.

5 The sale of the vehicle was evidenced by two documents: a shipping document and a unit invoice. The invoice stated the terms as being "net 10 days". On the back of the invoice there were printed terms and conditions which included:

1. Title and ownership in the property described in this invoice shall remain vested in the seller and shall not pass to the dealer until the purchase price has been paid in full.

. . . . .

6. The dealer certifies that he is an authorized and registered dealer purchasing the property for resale.

6 The invoice contained a box "delivery acknowledgment" which was not completed. There was no signature by Rumble or by Maxwell on either document.

7 Following delivery, General had an interest in the vehicle to which the provisions of the PPSA applied which was an unperfected security interest within the meaning of that statute: see *Banque Nationale de Paris (Can.) v. Pine Tree Mercury Sales Ltd.*, (1983) 42 O.R. (2d) 303, 47 C.B.R. (N.S.) 300, 3 P.P.S.A.C. 51 (Ont. Co. Ct.).

8 By sale agreement dated August 25, 1980, Rumble sold the vehicle to Misener for $31,994 which on its face represented a modest gross profit of $1,700. By agreement dated the same day, Misener leased the vehicle to Maxwell for a 24 month term commencing on that day. Norman Maxwell Holdings Limited gave a cheque also dated August 25, 1980, which was said to represent the first and last month's rent. There was an Ontario transfer vehicle permit dated August 25, 1980, issued in the name of Misener. Norman Maxwell Holdings Limited executed an undated payment authorization form to its then bank which apparently was not received by the bank until September 8, 1980. Misener did not pay the purchase price to Rumble until August 28, 1980, which was three days after the commencement of the lease and the first payment of rent. The vehicle remained on the Rumble lot and Misener never acquired physical possession of it.

9 It is the testimony of David Teversham, who was at all relevant times the president of Misener, that Misener was approached by Maxwell on behalf of Rumble with a plan for the financing of a vehicle rental scheme which, after consideration, was rejected by Misener. Misener was then requested to purchase the vehicle from Rumble and lease it to Maxwell which, after investigation, it agreed to do. The transaction enabled Maxwell to finance the acquisition of the vehicle and provided Misener with rental income and deductible capital cost allowance for income tax purposes.

10 The PPSA applies to a lease intended as security. It is the position of Misener that the lease was a "true" lease not intended as security. General contends that the lease evidenced a financing transaction to which the PPSA applies.

11 The lease called for 24 monthly payments of $994.69 each plus applicable sales tax. The aggregate amount of rent

payable under the lease was $23,872.56. The lease might fairly be described as a "net" lease, the lessee being responsible for repairs and insurance. It was provided that the lessee may not assign without consent. There were the following provisions with respect to purchase option and renewal:

At the expiration of the term of this lease, provided the Lessee shall have paid all sums due under this lease and is not otherwise in default hereunder, the Lessee may purchase the Leased Vehicle in its then condition and at its then location for its estimated fair market value of $15,997.00 (Purchase Option Price) plus any applicable taxes thereon and the cost of obtaining a certificate of mechanical fitness, if applicable. Provided, however, that Lessee shall have given Lessor not less than thirty days' notice of its intention so to purchase.

In the event the Lessee does not purchase the Leased Vehicle at the expiration of the term of this lease, this lease shall automatically be renewed for a further twelve month period under the same terms and conditions as contained herein.

However, upon expiration of this twelve month renewal period, provided Lessee shall have paid all sums due under this lease, and is not otherwise in default hereunder, Lessee may purchase the Leased Vehicle, in its then condition and at its then location, at its then fair market value being the value of a vehicle of like model and description having suffered only normal and reasonable wear and tear, plus any applicable taxes thereon and the cost of obtaining a certificate of mechanical fitness, if applicable. Provided, however that Lessee shall have given no less than thirty days' notice of its intention so to purchase.

In the event the Lessee does not purchase the Leased Vehicle at the expiration of the twelve month renewal period, Lessor may sell the Leased Vehicle by private or public sale, and in the event the net purchase price received from such sale by the Lessor is, by reason of unreasonable wear and tear suffered by the Leased Vehicle, less than the fair market value, as defined above, Lessee shall pay to Lessor the difference between the net purchase price received and the fair market value, within ten days from receipt by Lessee of notice of such deficiency.

12 It is noted that the first option at the end of the two year term was for an "estimated fair market value" which was precisely 50 per cent of the price paid by Misener to Rumble. There was no evidence as to whether that was a reasonable estimate. If the option were not exercised, there was an automatic renewal for 12 months following which Maxwell might purchase the vehicle "at its then fair market value being the value of a vehicle of like model and description having suffered only normal and reasonable wear and tear". If the option was not exercised, Misener could sell the vehicle and recoup any deficiency between the purchase price received and the fair market value that had occurred by reason of unreasonable wear and tear suffered by the leased vehicle.

13 The lease provided for termination and repossession in case of certain defaults and "if the lessor decides, as it may in its sole discretion, that its security hereunder is impaired or is in jeopardy". In such an event, the lessor had the right to sell and to look to the lessee for any deficiency if the proceeds were less than the aggregate of future rental payments and the option payment at the end of the first term.

14 The lease, in effect, provided for payment of all rentals in any event together with a recovery on termination of the entire moneys paid by Misener or fair market value of the vehicle. While the matter is not entirely free from doubt, it is my opinion that in all the circumstances, the lease was intended as security for money paid by Misener to Rumble and that the PPSA does apply to it. Accordingly, Misener would have had at the completion of the purchase and lease transactions, an unperfected security interest.

15 On September 4, 1980, General took possession of the vehicle and subsequently sold it.

16 On September 5, Misener registered a financing statement under the PPSA in which Misener was named as a secured party and Maxwell was named as the debtor.

17 General takes the position that title to the vehicle did not pass to Rumble and furthermore, that there was an understanding that Rumble would not deal with the vehicle and the other units contemporaneously delivered until General had been paid for them. Accepting that to be so, it is not of assistance in determining the issue of priority. The

issue is which security interest in the vehicle should prevail. In such a determination, title is not a relevant consideration: see *Nat. Trailer Convoy of Can. Ltd. v. Bank of Montreal* (1980), 10 B.L.R. 196, 1 P.P.S.A.C. 87 (Ont. H.C.); and *Ford Motor Credit Co. of Can. Ltd. v. Centre Motors of Brampton Ltd.* (1982), 38 O.R. (2d) 516, 2 P.P.S.A.C. 63, 137 D.L.R. (3d) 634 (Ont. H.C.).

18 The next question to consider is whether Rumble sold the vehicle to Misener in the ordinary course of business. This is because of s. 30(1) of the PPSA which provides:

30.(1) A purchaser of goods from a seller who sells the goods in the ordinary course of business takes them free from any security interest therein given by his seller even though it is perfected and the purchaser actually knows of it.

19 On their face, the sale by Rumble to Misener and the lease by Misener to Maxwell were in the ordinary course of business of both Rumble and Misener. The business of Rumble included the selling of mobile homes and the business of Rumble included the financing of vehicle transactions by buying and leasing. There are two inter-related circumstances which it is submitted take the transaction outside s. 30(1). It was submitted first that the Misener involvement was of a financing nature and that the transaction should not be regarded simply as a purchase from one party and a lease to another. Secondly, it was submitted that thelease was made to Maxwell who was known by Misener to be a principal of Rumble. In *Fairline Boats Ltd. v. Leger*, (1980) 1 P.P.S.A.C. 218 (Ont. H.C.), Mr. Justice Linden expressed the opinion at p. 223 that "if the buyer is not an ordinary customer, but a dealer or financial institution, then the Court may take this out of the ordinary course of business, but not necessarily so because dealers and others too may, in proper circumstances, receive the benefit of the provision."

20 Misener was a financier. The lease agreement was on its printed form. As I have found, the lease was intended as security for the repayment by Maxwell, with interest, of the moneys paid to Rumble. It was a common type of arrangement. Nevertheless, the transaction between Misener and Rumble was a purchase and sale. There is no qualification on the word "purchaser" in s. 30(1) and in my opinion, no basis for excluding purchasers who acquire goods as part of a financing transaction. If Misener were found to be not entitled to the protection of s. 30(1), it would be in a worse position than purchasers of chattel paper and non-negotiable instruments who are also usually financiers and who are protected by other provisions in s. 30.

21 The issue as to whether Rumble sold in the ordinary course of business comes down to the involvement of Maxwell. If the lessee had been a person independent of Rumble, there would be no doubt about the result. Rumble sold for cash and made a profit. There is no evidence to suggest that the sale was for less than fair market value. However, it can be assumed that Rumble knew that Maxwell was to be the lessee under an arrangement where, in effect, he would have the rights and obligations of an owner of the vehicle. In that context, can the sale by Rumble be regarded as in the ordinary course of business?

22 In general, there is nothing improper or unusual about a transaction between a company and its principal shareholder. The purpose of s. 30(1) is to protect purchasers. Misener knew there was a relationship between Rumble and Maxwell but was unaware of its nature and extent. To Misener, it was not an unusual transaction and it had no reason to consider that Rumble was not selling in the ordinary course of its business. It does not seem to me that a sale which on its face was clearly in the ordinary course of the sellers business should be otherwise regarded simply because it was part of a financing transaction involving a principal of the seller.

23 It was submitted that the timing of the transactions took them out of the ordinary course of business. The lease, Sched. "A" thereto, the transfer of vehicle permit and the rental cheque are all dated August 25, 1980. Misener did not pay the purchase price until three days later on August 28. I do not consider this to be a significant factor in determining whether the sale to Misener was in the ordinary course of business. Admittedly, Misener would not have purchased the vehicle unless it could have immediately leased it to Maxwell. It would be normally prudent for Misener to be sure that the lease transaction was in place before completing the purchase.

24 The funds provided by Misener should have been used to pay the amounts owing to General. Presumably, they were not so used and both Rumble and Maxwell would have known that the understanding with General had thereby been breached. Misener was not aware of the security interest of General or of its arrangement with Rumble. As I have said, Misener had no reason to consider that the transaction was not in the ordinary course of business. Section 30(1) of the PPSA frees a purchaser from a security interest given by a seller even if he actually knows of such interest. The purpose of the section is to enable purchasers to enter into transactions without inquiry.

25 Having regard to all the circumstances, I am satisfied that Rumble sold to Misener in the ordinary course of business and that therefore, Misener took free of any security interest of General. Misener is therefore, entitled to judgment.

26 It is unnecessary to decide whether s. 10 of the PPSA is applicable to prevent General from asserting its claim to priority over Misener. It was submitted that the section was applicable because Rumble did not sign a security agreement with General. I may say that I have some doubt that this action can be characterized as an enforcement by General of its security interest against Misener.

27 There will be judgment to Misener in the agreed amount of $29,865.36 with prejudgment interest as agreed at the rate of 12.75 per cent per annum from December 1, 1980. Misener should also have its costs.

Order accordingly.

END OF DOCUMENT

ROYAL BANK OF CANADA v. MARTIN, DRAKE and SNOOK
(1982 No. 146)

Newfoundland Supreme Court
Court of Appeal
Morgan, Gushue and Mahoney, JJ.A.
May 15, 1985.

.mmary:
n 1980 the Royal Bank of Canada ob-
ıined an order for possession of a
ıtor home. The chattel mortgagee was
ırtin, but he had sold the mobile
ıme to Drake, who in turn sold it to
ıook, neither of whom knew about the
ıattel mortgage. Drake appealed, chal-
ınging the validity of the chattel
ırtgage and claiming that defects in
ıe chattel mortgage should not have
ıen corrected by the court.

The Newfoundland Court of Appeal al-
ıwed the appeal and set aside the
ıder for possession on the ground
ıat the chattel mortgage was fatally
ıefective.

HATTEL MORTGAGES AND BILLS OF SALE - TOPIC 2231
Registration and filing - Registration - Effect of - General - The Newfoundland Court of Appeal held that the fact of registration itself is irrelevant in determining the validity of a defective chattel mortgage - See paragraphs 12 to 13.

HATTEL MORTGAGES AND BILLS OF SALE - TOPIC 2294
Registration and filing - Contents of bill or mortgage - Curing of defects - In addition to the slight misdescription of a motor home and the slight mistake in serial number a chattel mortgage failed to include the promissory note containing the loan agreement and the terms of defeasance between the parties - Further, its date of execution did not conform with date stated in the affidavit of execution - The Newfoundland Court of Appeal held that the chattel mortgage was fatally defective and could not be cured under s. 21 of the Bills of Sale Act, R.S.N. 1970, c. 21.

CASES NOTICED:
Gordon v. Garry J. Carter of Canada Ltd., 4 D.L.R.(2d) 542, ref'd to. [para. 8].
Iverson v. Sherman, 59 W.W.R.(N.S.) 252, ref'd to. [para. 8].
Golden Mile Motors v. Bank of Montreal, 12 D.L.R.(3d) 336, ref'd to. [para. 8].
Re Scott, 40 D.L.R.(2d) 328, ref'd to. [para. 8].
Ball and Wheldon v. Royal Bank of Canada (1915), 52 S.C.R. 254, ref'd to. [para. 8].
Traders Finance Corp. v. Nova Scotia Trust Co. (1960), 45 M.P.R. 235, appld. [para. 13].
Re Fortune & Company Limited (1981), 38 Nfld. & P.E.I.R. 169; 108 A.P.R. 169, dist. [para. 14].

STATUTES NOTICED:
Bills of Sale Act, R.S.N. 1970, c. 21 ss. 2(b) [para. 10]; 5(1), 5(2) [para. 11]; 7(3) [para. 10]; 21 [para. 6].

COUNSEL:
Donald MacBeath, for the third defendant-appellant;
Garry Handrigan, for the second defendant-respondent.

This case was heard on January 16, 1985, at St. John's, Newfoundland, before Morgan, Gushue and Mahoney, JJ.A., of the Newfoundland Supreme Court, Court of Appeal.

On May 15, 1985, Gushue, J.A., delivered the following judgment for the Court of Appeal:

[1] Gushue, J.A.: This appeal is taken by William Drake against the order of Noel, J., dated July 19, 1982, in which he granted the application of the Royal Bank of Canada for possession of a motor home, pursuant to the provisions of a chattel mortgage taken by the Bank from Ronald Martin in June 1979 and registered in the Provincial Registry of Bills of Sale and Conditional Sales on July 25, 1979, as No. 372843.

[2] Martin apparently retained the

motor home until May or June 1980, when he sold it to the appellant Drake. On February 5, 1981, Drake sold the motor home to the respondent Frank Snook. In November 1981 Martin defaulted on his payments to the bank, and the bank subsequently applied to the Trial Division by way of originating summons for possession of the motor home. It appears from the affidavit of Snook that he was unaware at the time he purchased the unit that there had been an owner prior to Drake. He stated that he had occasioned a search for encumbrances to be made at the Registry of Bills of Sale, but found nothing. One presumes that he searched only in Drake's name. No evidence was adduced as to whether or not Drake had made any such search. Presumably, he did not.

[3] The learned trial judge found that the registration of the chattel mortgage by the bank constituted adequate notice to the subsequent purchasers. He applied the remedial provisions of s. 21 of the **Bills of Sale Act**, R.S.N. 1970, c. 21 (the **Act**) to correct certain omissions and irregularities in the mortgage document and concluded that the bank was entitled to possession. Drake takes issue with these findings on the grounds, firstly, that the **Sale of Goods Act**, R.S.N. 1970, c. 341, and specifically s. 27(1) thereof, stipulates against that proposition, there being no reference to such notice in the **Bills of Sale Act**; and, secondly, the defects in the chattel mortgage amounted to non-compliance with the **Bills of Sale Act** and rendered the mortgage unenforceable as against subsequent purchasers for value.

[4] At the hearing before this court, the bank chose not to appear. Apparently, subsequent to the order of Noel, J., it reached an accommodation with Snook which enabled the latter to retain the motor home. Snook has taken a separate action against Drake, but meanwhile Drake takes this appeal.

[5] I shall deal with the latter ground of appeal first. There were indeed certain omissions and irregularities in the chattel mortgage, viz. different dates and locations appearing in the affidavit of execution, some uncertainty with regard to whether the document was filed in the Registry in accordance with the **Act's** prescription as to time, slight errors in the description and serial numbers of the vehicle and, most significantly, a failure to attach the promissory note containing the loan agreement between the parties, as required by the **Act**.

[6] Section 21 of the **Act** states as follows:

> "21. A document to which this **Act** applies shall not be invalidated or its effect destroyed by reason only of a defect, irregularity, omission or error therein or in the execution or attestation thereof unless, in the opinion of the court or judge before whom a question relating thereto is tried, the defect, irregularity, omission or error has actually misled some person whose interests are affected by the document."

In interpreting this section, which he did during the course of the hearing and without the benefit of any sustained argument or authorities on the issue, the learned judge stated:

> "If the Bank takes a bill of sale on a chattel and registers it, unless that bill of sale is void, in which case the bank has no standing anyway, a subsequent purchaser has no cause for complaint unless he has been misled by the document that was filed. Now, in the present case your clients are stuck unless the bill of sale was void or unless they were misled."

[7] He then went on to say that:

> "... the fact of the matter is that the **Bills of Sale Act** says that if a bill of sale is registered, the bill of sale is good against your clients unless your clients have been misled."

And concluded that, because neither Drake nor Snook had been misled, the

bank was entitled to possession of the mobile home.

[8] There are a great many reported cases on the interpretation of curative sections, similar to the Newfoundland s. 21, in **Bills of Sale Acts** in various Canadian jurisdictions. Most of these are of little assistance because of slightly different wording in the **Act** and, of course, differing fact situations. However, the ratio of these cases generally is that if the bill of sale (which includes a chattel mortgage) is given in accordance with the provisions of the **Act** and properly registered, then a clerical, typographical or descriptive error which has not misled a person claiming relief (or, in some jurisdictions, which might tend to mislead such a person) will not invalidate the document or destroy its effect. However, despite the obviously broad wording of the curative sections, such a section cannot operate to remedy or cure a total disregard of the specific and mandatory provisions of the **Act** which must be complied with to make a document a bill of sale within the meaning of the **Act**, as well as those provisions that are a prerequisite to the registration thereof. In other words, s. 24 cannot cure an incurable defect. (See **Gordon v. Garry J. Carter of Canada Ltd.**, 4 D.L.R.(2d) 542, **Iverson v. Sherman**, 59 W.W.R. (N.S.) 252, **Golden Mile Motors v. Bank of Montreal**, 12 D.L.R.(3d) 336, **Re Scott**, 40 D.L.R.(2d) 328, and **Ball and Wheldon v. Royal Bank of Canada** (1915), 52 S.C.R. 254).

[9] If the only irregularities in the document in this case were in relation to the word "Toronto" appearing in the affidavit of execution as well as "St. John's", or even the slight misdescription of the motor home and the slight mistake in the serial number, I would have no hesitation in accepting the learned Chamber's judge's statement that these had no effect on either the appellant or respondent and were thus curable. However, with respect, I am unable to accept that the complete failure to file the promissory note containing the loan agreement and terms of defeasance between the parties is a curable defect. Nor am I satisfied that the chattel mortgage has been properly identified, in terms of its date of execution, as required by the **Act**.

[10] A bill of sale is clearly defined in s. 2(b) of the **Act** as "a document in writing in conformity with this **Act** evidencing a sale or mortgage of chattels ...". Section 7(3) provides that "no bill of sale shall be registered unless it is accompanied by an affidavit of an attesting witness ... of the execution thereof by the grantor ... identifying the bill of sale and stating the date of execution by the grantor ...". (My emphasis). The affidavit of execution in this instance, in what appears to be the handwriting of the witness, attests that the chattel mortgage was executed on June 13, 1979, while the date on the chattel mortgage itself is June 28, 1979. If the affidavit is correct, then the document was registered outside the 30 day period stipulated by s. 7(1) of the **Act**. In my view, such an error might well be a curable defect if evidence were given to establish that the correct date was June 28, but I am not convinced it is curable otherwise. In any event, I would not decide this matter on that issue alone, but I am of the view that the appeal must succeed because of the failure to comply with ss. 5(1) and 5(2).

[11] In this matter, the chattel mortgage document which was registered on July 25, 1979, contains no details whatever of the loan agreement, although reference is made to a "Schedule A" which sets out the conditions of the loan and the agreement, as well as default provisions. There was in fact such a Schedule A, which contained the loan agreement, but it was not registered. Section 5(1) of the **Act** stipulates that "Every schedule annexed to a bill of sale or referred to therein shall be deemed to be a part of the bill of sale and shall be registered therewith". Section 5(2) provides that "If a bill of sale is subject to any

defeasance, condition or trust, the terms or substance of the defeasance, condition or trust shall be set forth in the bill of sale or in a schedule annexed thereto or referred to therein". (My emphasis)

[12] In my view, the document registered on July 25, 1979, did not conform to the mandatory requirements for registration under the **Act** and was thus clearly not "a document in writing in conformity with this Act". It should not have been accepted for registration and the fact that it was so accepted is irrelevant, because under the **Act** it could have no legal validity and the omission to file the loan agreement - an essential aspect of the mortgage - was not an omission which could be cured by a court under s. 21. Further, whether or not the prospective purchasers were misled is irrelevant.

[13] As to the fact of registration itself, I would adopt the statement of Patterson, J., in **Traders Finance Corp. v. Nova Scotia Trust Co.** (1960), 45 M.P.R. 235, at page 242, where he said:

> "It seems to me that when any person takes a document to the Registry of Deeds to be filed or registered, he must assume some responsibility in seeing that it is a document that the Registrar under law must register or file. One cannot expect a Registrar to assume judicial functions and refuse to register or file a document which, if his refusal is not legal, might expose him to dire consequences."

[14] This matter, I would add, is quite different from the case of **Re Fortune & Company Limited** (1981), 38 Nfld. & P.E.I.R. 169; 108 A.P.R. 169, a decision of Goodridge, J., of the Trial Division, which is heavily relied upon by counsel for Snook. In that matter, the name of the holder of goods under a conditional sales contract was stated incorrectly as "Fortune Ltd." rather than "Fortune & Company Limited". That did not make the document in any way unregistrable and it was then within the discretionary powers of the trial judge to remedy the defect.

[15] It follows obviously that the appeal must succeed and that there is no need to consider the first ground of appeal.

[16] In the result, the appeal is allowed and the order for possession of the vehicle in favour of the Royal Bank of Canada is set aside. The appellant will have his costs against the Royal Bank of Canada (the plaintiff-respondent) here and in the court below.

Appeal allowed.

Editor: David C.R. Olmstead
pdj

informer, as well as any other circumstances which may have had a bearing on the requested disclosure order, would have been dealt with. The fact that the defence chose, rather, to move for a stay of proceedings does not give it greater rights than it could have claimed had it followed the proper route.

[41] Moreover, assuming, for the sake of argument, that the Court of Appeal's judgment in the first trial could be construed as an "order" to produce the police informer, it is clear that such an order would have gone much beyond *R. v. Stinchcombe* (1991), 68 C.C.C. (3d) 1, [1991] 3 S.C.R. 326, 9 C.R. (4th) 277, *i.e.*, much beyond the type of disclosure that can be ordered by a trial judge, let alone a Court of Appeal. The Crown can only be ordered to produce what it has, and it does not "have" people. I agree with my colleagues in this respect that "[t]he obligation of the Crown does not extend to producing its witnesses for oral discovery" (at para. 18). The appellants' argument on this point must accordingly fail.

[42] The other issue in dispute in the present appeal concerns the alleged unreasonable delay which the trial judge considered in ordering the stay of proceedings. I agree with my colleagues that no such unreasonable delay occurred in the circumstances of this case.

[43] For these reasons, I agree with my colleagues that a stay of proceedings should not have been granted in the instant case. I would, however, uphold the Court of Appeal's order of a new trial and direct the question of the extent of disclosure to the trial judge. Accordingly, I would dismiss the appeal.

Appeal allowed.

Re Sun Life Assurance Co. of Canada and Royal Bank of Canada et al.

[Indexed as: Sun Life Assurance Co. of Canada v. Royal Bank of Canada]

Court File No. B68/94

Ontario Court (General Division), Winkler J. *November 8, 1995.*

Personal property security — Security interests — Priorities — Subordination — Bank registering security interest with respect to existing and future collateral — Life insurance company subsequently registering security interest with respect to debtor's collateral at new location — Bank appearing to subordinate security interest to that of life insurance company — Subordination given in error — Priorities to be determined in accordance with order of registration — Personal Property Security Act, R.S.O. 1990, c. P.10, s. 38.

The bank gave a credit facility to the debtor and registered a general security agreement in respect of the facility. 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 this application for an order determining the priorities between the two creditors.

Held, the bank had priority.

Section 38 of the *Personal Property Security Act*, R.S.O. 1990, c. P.10, 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 not a party to it. However, there was no subordination agreement between the bank and the debtor. The bank was never requested to subordinate its interest to that of the life insurance company and it did not intend to 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 is an exception to the registration scheme of the statute, the waiver of priority must be clear and unequivocal and made with full knowledge of the circumstances. Since the latter was lacking on the part of the bank, priorities should be determined in accordance with the order of registration. Accordingly, the bank had priority over the life insurance company.

Euroclean Canada Inc. v. Forest Glade Investments Ltd. (1985), 16 D.L.R. (4th) 289, 54 C.B.R. (N.S.) 65, 4 P.P.S.A.C. 271, 40 O.R. (2d) 769, 8 O.A.C. 1, 29 A.C.W.S. (2d) 421; leave to appeal to S.C.C. refused 16 D.L.R. (4th) 289*n*, [1985] 1 S.C.R. viii, 55 C.B.R. (N.S.) xxvii, 10 O.A.C. 159*n*; *Royal Bank of Canada v. Tenneco Canada Inc.* (1990), 66 D.L.R. (4th) 328, 9 P.P.S.A.C. 254, 72 O.R. (2d) 60, 19 A.C.W.S. (3d) 382, **consd**

Other cases referred to

Federal Business Development Bank v. Steinbock Development Corp. Ltd. (1983), 42 A.R. 231

Statutes referred to

Personal Property Security Act, R.S.O. 1990, c. P.10, ss. 38, 67

APPLICATION for an order determining priorities between competing personal property security holders.

L. Thomas Forbes, Q.C., and *Navin Khanna*, for applicant.
John F. Scheulderman, for respondent, Royal Bank of Canada.

WINKLER J.:—This is an application by Sun Life Assurance Company of Canada (Sun Life) for an order under s. 67 of the *Personal Property Security Act*, R.S.O. 1990, c. P.10 (PPSA),

determining a question of priority over collateral located at Dodge Suites Hotel in the Town of Vaughan.

a Dodge Suites Hotel Inc. (Dodge) owns and operates a hotel in the City of Mississauga and another hotel in the Town of Vaughan.

In November, 1989, the Royal Bank of Canada (RBC) granted Dodge a credit facility in the amount of $1,250,000 as working capital for the Mississauga Hotel. A general security agreement
b entered into on December 5, 1989, between RBC and Dodge to secure the credit facility was registered under the PPSA on December 18, 1989.

A credit facility which had been granted earlier by another lender, Central Guarantee Trust, was registered prior to the RBC
c facility, and was referenced in the RBC general security agreement. The Vaughan hotel had not yet been built, and is thus not mentioned.

The RBC general security agreement grants by its terms to RBC a security interest in all collateral of Dodge in existence or subsequently acquired.

d In November, 1989, Dodge obtained a credit facility of $12 million from Sun Life to finance construction of the Vaughan Hotel. On April 23, 1990, Dodge and Sun Life entered into a personal property security agreement giving to Sun Life a security interest in all collateral owned by Dodge at the Vaughan
e hotel. This security agreement was registered under the PPSA on April 3, 1990.

Despite the prior registration of the RBC general security agreement, it was the intention of Dodge and Sun Life that Sun Life should, as construction financier of the Vaughan hotel, have
f first priority over the collateral at the Vaughan hotel. Dodge represented and covenanted to this effect.

Moreover, notwithstanding the prior registration of the RBC facility, on August 29, 1991, F.C. Kraemer, the RBC account manager involved with Dodge, prepared an annual credit facility
g review of the Dodge loan in which he assessed the RBC collateral security value to be nil, due to "prior" security interests in favour of Central Guarantee and Sun Life, in a total amount of $18,895,000.

On February 28, 1992, RBC entered into a commitment letter
h with Dodge over the signature of F.C. Kraemer, manager, corporate banking, setting out the terms of the credit facility. It seems clear on the face of this document that RBC subordinated its secured interest in the Vaughan hotel chattels to that of Sun Life. The document states at p. 4:

Collateral Security:

General Security Agreement representing a charge against all assets of Borrower ... subject only to prior encumbrances not exceeding $18,895,000 in favour of ... and Sun Life of Canada.

The amount of the combined Central Guarantee and Sun Life debt was $18,895,000.

A subsequent annual credit review, prepared by Mr. Kraemer for RBC on August 26, 1992, also showed the RBC general security agreement valued at a minimum acceptable value of "nil" based on the prior security interests of Central Guarantee and Sun Life. The evidence of Mr. Kraemer's explanation for these documents and my findings in this respect are dealt with below.

Restructuring negotiations took place beginning in July, 1991, involving Dodge and RBC, Central Guarantee and Sun Life, Dodge's primary lenders. In the course of these various discussions Sun Life asserted to Dodge its first position in priority with respect to the Vaughan hotel collateral, to which Dodge gave the appropriate assurances. RBC was not a party to this discussion or agreement.

It was during the restructuring negotiations in 1993, when Dodge continued to experience difficulties servicing its debts, that RBC took the position that it had priority over the Sun Life loan facility.

Hence the instant proceeding.

The issues

Sun Life asserts that, relying upon s. 38 of the PPSA, irrespective of a secured party's registered priority under the PPSA, the secured party may, in the security agreement or otherwise, subordinate its security interest to any other security interest. The applicant points to the commitment letter between RBC and Dodge, as well as the annual credit reviews prepared by Mr. Kraemer dated August 29, 1991 and August 26, 1992, as clear evidence of acknowledgement by RBC of subordination of its security interest to that of Sun Life.

RBC responds by stating that there was no such subordination and, in the alternative, if there was, it was in error.

The issues are, therefore:

1. Was there subordination of the security interest of RBC to that of Sun Life?
2. If so, was this done in error?
3. If it was done in error, is Sun Life entitled to the relief sought?

Analysis and discussion

As stated, Sun Life relies on s. 38 of the PPSA for the subordination of the security interest of RBC to that of Sun Life, notwithstanding the priority of registration of the RBC security.

Section 38 of the Act provides:

> 38. A secured party may, in the security agreement or otherwise, subordinate the secured party's security interest to any other security interest and such subordination is effective according to its terms.

Section 38 (then s. 39) was considered by the Ontario Court of Appeal in *Euroclean Canada Inc. v. Forest Glade Investments Ltd.* (1985), 16 D.L.R. (4th) 289, 54 C.B.R. (N.S.) 65, 4 P.P.S.A.C. 271 (leave to appeal to the Supreme Court of Canada dismissed June 3, 1985 [reported 16 D.L.R. (4th) 289*n*, [1985] 1 S.C.R. viii, 55 C.B.R. (N.S.) xxvii]). In *Euroclean*, the debtor gave a floating charge debenture to the defendant trustee to secure an indebtedness. The debenture covered all property of the debtor, including after-acquired property, and was duly registered. Subsequently, Euroclean sold equipment to the debtor, but registration of the security under the PPSA was late and was thus unperfected. However, the debenture contained a subordination clause and the purchase of the equipment came within it. Houlden J.A. (Blair J.A. concurring) held that Euroclean could enforce the subordination clause, even though unregistered, and even though not a party to the contract. Houlden J.A. stated at pp. 301-2:

> If s. 39 means only that a subordination clause is enforceable by a third party who is a party to the agreement which created it, the section is bootless, as it adds nothing to the common law. In my opinion, s. 39 is intended to confer a statutory right on a secured party to waive the priority given him by the PPSA and to confer a corresponding right on the beneficiary of such a waiver to enforce it, even though he is not a party to the agreement which created it or has no knowledge of its existence.

In *Royal Bank of Canada v. Tenneco Canada Inc.* (1990), 66 D.L.R. (4th) 328, 9 P.P.S.A.C. 254, 72 O.R. (2d) 60 (H.C.), Yates J. considered s. 38 and followed *Euroclean*. There, although there was no formal subordination agreement, the court considered the instructions given by the bank to its solicitors in the context of parol evidence and concluded at pp. 337-8:

> On the evidence before me, I am satisfied that the Bank did agree with Parkhill to subordinate its first floating charge to the interests of the defendants with respect to specific items of inventory financed by the defendants, even though no formal subordination agreement existed between the Bank and the defendants and neither of the two security documents, the debenture or the wholesale agreement, adverted to subordination. The agreement is evidenced by the testimony of Mr. Blattman, the

witness for the Bank, and by documents prepared by the Bank both before and after the debenture was taken from Parkhill. The subordination agreement is enforceable by the defendants even though they may not have been parties to it ...

It is clear that Sun Life can enforce a subordination agreement as against RBC, even though not a party to such agreement, and with no prior knowledge of it. The threshold question is, however, whether a subordination agreement exists between RBC and Dodge. In my opinion it does not. RBC was never requested to subordinate its security to that of Sun Life. There is no evidence that it ever intended to do so. On the contrary, it is Mr. Kraemer's evidence that he, at all times, was of the view that the RBC security had priority over that of Sun Life. His explanation for the purported priority given to Sun Life in the commitment letter prepared by him concerning Dodge, was that he was in error in assuming the existence of a postponement agreement such as was in place respecting Central Guarantee. I accept his evidence.

Furthermore, evidence of the understanding as between Dodge and Sun Life does not establish a subordination agreement as between RBC and Dodge in favour of Sun Life. In order to establish that RBC intended to waive the priority conferred upon it pursuant to the PPSA, more cogent evidence would be required than is present here; at least more than the three documents relied on by Sun Life, and given the explanation proffered in that respect by Mr. Kraemer. There was no evidence that Sun Life relied in any way upon these three documents. I am not satisfied that RBC intended to waive its priority in favour of Sun Life or that it in fact did so.

The PPSA provides a registration regime, the purpose of which is to impart order and certainty to commerce. To the extent that s. 38 of the Act provides an exception to this, it must be applied by the courts cautiously. Although the waiver of priority may, on the plain wording of the section, be contained in the "security agreement or otherwise", it must, nevertheless, be in clear and unequivocal terms. Hence the words of the section that "... such subordination is effective according to its terms". Waiver requires that there be full knowledge of the circumstances and the unequivocal intention to relinquish the right to be relied upon: see *Federal Business Development Bank v. Steinbock Development Corp. Ltd.* (1983), 42 A.R. 231 (C.A.).

In *Euroclean* there was an express subordination clause. In *Tenneco*, the instruction to solicitors was salient. In the case at bar the evidence falls short of establishing waiver.

In light of this disposition, it is unnecessary to deal with any remaining issues. The application is accordingly dismissed. The priorities shall be in accordance with registration. I may be spoken to by telephone conference call regarding costs.

Application dismissed.

Re Minkarious and Abraham, Duggan

[Indexed as: Minkarious v. Abraham, Duggan]

Court File No. 34,584/94

Ontario Court (General Division), E.I. MacDonald J. *November 15, 1995.*

Civil procedure — Costs — Assessment — Paid accounts — Limitation period — Special circumstances — Client in matrimonial proceedings paying interim accounts but not final accounts — Lawyer opposing any assessment of paid accounts — Interim accounts part of continuum — Limitation period not commencing until after delivery of final account — Special circumstances warranting assessment — Payment of interim accounts not raising presumption of satisfaction — Fees appearing high — Assessment of all accounts ordered — Solicitors Act, R.S.O. 1990, c. S.15, ss. 3, 4, 11.

Civil procedure — Costs — Assessment — Place of assessment — Assessment ordered where proceedings took place rather than where lawyer's office located — Rules of Civil Procedure, R.R.O. 1990, Reg. 194, rule 58.02(1).

Family law — Costs — Assessment — Client in matrimonial proceedings requesting assessment of accounts — Client paid interim accounts but not final accounts — Lawyer opposing any assessment of paid accounts — Interim accounts part of continuum — Limitation period for assessment of accounts not commencing until after delivery of final account — Special circumstances warranting assessment — Payment of interim accounts not raising presumption of satisfaction — Fees appearing high — Assessment of all accounts ordered — Solicitors Act, R.S.O. 1990, c. S.15, ss. 3, 4, 11.

Statutes — Interpretation — Particular terms — "Special circumstances" — Solicitors Act (Ont.), s. 11 — Provision allowing for assessment of paid accounts if "special circumstances" require — Not confined to cases of fraud or gross misconduct — Solicitors Act, R.S.O. 1990, c. S.15, s. 11.

A client brought an application pursuant to ss. 3, 4 and 11 of the *Solicitors Act*, R.S.O. 1990, c. S.15, for an order referring for assessment all interim and final accounts delivered to him by his solicitor in a matrimonial action. The client received seven interim accounts from the solicitor in an eight-month period between July, 1993 and April, 1994, and two final accounts in June, 1994. The first six of the interim accounts were paid, the seventh was partially paid, and the two final accounts remained unpaid. The application for assessment of accounts was initiated more than one month but less than 12 months following delivery of the final accounts. However, it was brought more than 12 months after the first two