LAW REFORM COMMISSION OF BRITISH COLUMBIA

REPORT ON

THE BUYER'S LIEN: A NEW CONSUMER REMEDY

LRC 93

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The Law Reform Commission of British Columbia was established by the *Law Reform Commission Act* in 1969 and began functioning in 1970.

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To THE HONOURABLE BRIAN R.D. SMITH, Q.C.
ATTORNEY GENERAL OF THE PROVINCE OF BRITISH COLUMBIA:

The Law Reform Commission of British Columbia has the honour to present the following:

REPORT ON THE BUYER'S LIEN: A NEW CONSUMER REMEDY

In today's marketplace for consumer goods a retail seller will frequently receive payment for goods before they are actually delivered to the buyer. If the seller should, say because of his insolvency, fail to deliver the goods, the buyer s legal position may be very precarious. Whether he gets his goods or receives a few cents on the dollar as an unsecured creditor of the seller may turn on the highly technical question of whether title to specific goods has passed to the buyer. This is determined with reference to the *Sale of Goods Act.*

Whatever the merits of this result may be in the context of commercial transactions, it has both the substance and appearance of unfairness when it defeats the reasonable expectations of the ordinary consumer buyer. While there is no way that the consumer can be fully protected from losses arising in this way there are some means by which his legal position can be improved so as to reduce the likelihood of loss.

In this Report it is recommended that the rights of the consumer be reinforced through the creation of a buyer's lien." This lien would enable the buyer to assert continuing rights in the prepayment itself and in the seller's inventory of goods of a kind that were the subject of the sale.

CHAPTER I

What are the rights of a buyer of consumer goods who has prepaid their purchase price but has not received possession of them? The problems which arise in this situation are illustrated by three requests for assistance which appeared in the "Action Line" column formerly carried by the Vancouver Province newspaper. The complaints, and Action Line's replies, are set out below in a slightly condensed form. The names of the persons and institutions involved have been omitted.

* * * * * *

Complaint

Last February, I spent $358.50 on house insulation at [seller's] Lumber ... about 40 miles from Port Alice where I was living at the time. I also paid another $20.00 for delivery. It was my bad luck that the store went into receivership a couple of days later -- before the insulation could be delivered ...

I was told [by the receiver] that because the goods had not been set aside for me there was nothing I could do to get the insulation or to get my money back

Surely there is some way that consumers can be protected in situations such as these.

Action Line's Reply

Afraid not, according to the receiver-manager who spelled out the details for us. “Section 23 of the Sale of Goods Act ... provides that title in goods passes generally when the goods are specific and ascertained” said the receiver. “In practice, we understand that this is intended to involve the separation and marking of goods for a customer or contract....”

“Our conclusion,” he said, “is that the merchandise which [the buyer] ordered was never removed from stock, in such a way as to become specific or ascertained and that the goods were also available to a subsequent purchaser who wished to take immediate delivery.

“We do not suggest that there appears to have been anything improper in the manner in which [the seller] accepted [the buyer’s] order. However, it does point out the problems involved in prepaying an account be ore taking custody of the merchandise. We are sympathetic toward [the buyer’s dilemma], but regret that we have no legal grounds on which to supply the goods she claims.” He added that you would be an unsecured creditor in any bankruptcy proceedings but said “...it is most improbable that there would be any funds available to the unsecured creditors in such a bankruptcy.

Action Line knows this will be absolutely no help to you, but we hope your experience will help other readers.

* * * * * *

Complaint

Toward the end of last November I went into [the seller’s] jewelry store.. .and arranged to buy a silver bracelet. I paid a deposit of $52.00 on a lay away plan that reserved the bracelet until I paid the full price of $299.00. By mid-January I had paid a total of $260.00 toward the full price and was quite happy to think that when I paid the last payment, would finally get the bracelet.

But when I went to the store on January 30th to make the last payment and pick up the bracelet, I was dumfounded to find the premises empty. The sign was still there, but the merchandise and fixtures were not ...

Could you help me get my money back or, preferably, the bracelet? Naturally, I would expect to complete payment.

Action Line's Reply

Your bracelet was being held with other [seller’s] stock, by ... a company that was appointed receiver-manager or he store, which has gone out of business.

The receiver-manager wrote to us to say, “I have notified all of the parties who had materials in on repair and also who had made deposits on lay away stock, but, unfortunately many of the items did not have either phone numbers or addresses so the parties could not be contacted.”

You were luckier than another reader who was holding a credit note. She is considered an unsecured creditor and is not likely to get any refund, said the receiver-manager.

Complaint

I ordered a four-piece walnut bookcase from [seller's] bookcase shop. I gave them a $560.00 down payment, but they never delivered the bookcase and I haven't been able to get my deposit refunded.

I asked Consumer and Corporate Affairs (B.C.) to help me get my deposit back and they referred me to [an accounting firm], which was appointed receiver-manager of [the seller] last September. I wrote to [the receiver-manager] and explained my problem. I haven't received a reply ...

I would like to know if [the seller] has gone out of business for good and if there is any possibility of getting my money back.

Action Line's Reply

[The receiver-manager] took possession of [the seller's] assets, primarily consisting of plant equipment and sundry materials at their Richmond location and sold them for about $55,000.00 said [a representative of the receiver-manager].

He said this amount wasn't enough to pay the claims of statutory creditors and three debenture holders that had to be paid before paying claims made by unsecured creditors such as yourself. There were no funds available to refund your deposit or a portion of it ...

These cases (hereafter referred to as the "insulation case," the "bracelet case" and the "bookshelf case" respectively) all involved a consumer who paid some or part of the purchase price of goods without taking delivery of them. In each case the seller became insolvent before he could complete his part of the bargain -- delivery of the goods to the buyer. These cases are not unique. They were selected because they illustrate most clearly the issues at stake.

It was cases such as these which prompted us to examine the rights of a buyer who has prepaid for consumer goods, but whose rights are jeopardized by a default on the part of the seller: a default usually arising out of the seller's *de facto* insolvency. There were two aspects to this examination. The first concerned the basic question whether, as an issue of legal policy, consumer buyers should be singled out as a particular favoured group. Are their claims different from those of non-consumer buyers or other classes of persons who may have claims on the seller?

A positive answer leads to the second aspect. Is it possible to enhance the legal position of the consumer buyer without significantly disrupting business practices or frustrating the legitimate expectations of other interested persons and groups? The challenge was to devise a new remedy geared to this particular problem. The result of our examination was embodied in a Working Paper that was distributed for comment and criticism in August 1986. Its title (the same as the title of this Report) suggests our tentative conclusion. It was both justifiable and possible to devise an appropriate new remedy. The responses and submissions which the Working Paper attracted were mixed. No attempt will be made to summarize them or deal with them at this point. Reference will be made to particular issues raised at appropriate points in this Report.

CHAPTER II

The examples set out at the beginning of Chapter I may leave the reader somewhat puzzled. To understand why one consumer should succeed in asserting rights against the seller while others should fail, it is necessary to consider briefly some of the legal machinery which may be triggered by a *de facto* insolvency and how it operates.

There is no fixed definition of insolvency. The core idea is that a person is insolvent if he is unable to satisfy his debts as they come due. Depending, however, on the particular legal context other features may be relevant to characterize a person as insolvent, and here definitions may differ slightly. For example, a person could be solvent for the purpose of one legal mechanism associated with insolvency, but not for the purpose of another.

There are three types of procedures which are commonly invoked by creditors with respect to a person who may be insolvent. These are bankruptcy, receivership, and execution proceedings by a judgment creditor. What they have in common is that the property of an insolvent person, or a portion of his property, is brought under the control of a third party to be dealt with so as to satisfy creditors.

Bankruptcy proceedings may be invoked where it is contemplated that all (with certain minor exceptions) of a debtor's property is to be liquidated. Such proceedings are governed by the *Bankruptcy Act*, a federal statute, and can only be brought where the insolvent person has generally failed to meet his obligations as they have come due.

When a person becomes bankrupt, his property vests in a "trustee in bankruptcy", a person licenced under the Act whose duty it is to gather in and liquidate the "estate" of the bankrupt person and distribute it among his creditors. The distribution among creditors takes place according to the priorities set out in the *Bankruptcy Act* and there may be many persons and bodies who have claims on the proceeds of the estate in priority to general creditors. These prior parties will include the trustee (for his fees and expenses), secured parties, governments and government agencies, various classes of "preferred creditors" and others. Very often, once these prior claims have been satisfied, there is very little or nothing left over for the general creditors whose only claim on the estate is with respect to a debt or other unsecured money liability.

Bankruptcy proceedings may be invoked either with respect to an insolvent business or an insolvent individual debtor.

Receivership is used almost exclusively with respect to business debtors. Typically, a commercial lender will advance credit to a businessman and in return take security in the form of a mortgage, debenture or similar instrument over all the borrower's business assets. Debentures usually contain a term that if the borrower defaults in repayment, or if certain other circumstances arise, the lender may, either on application to the court or under the terms of the instrument, appoint a receiver to take over conduct of the borrower's business. A receiver may be appointed simply to liquidate the borrower's business and see that t he proceeds are applied toward the discharge of the debt secured. He may also be appointed to take over the actual running of the business to restore it as a "going concern" so it can again become valuable security, or so that the profits may be used to discharge the debt. In the latter case, the person who does that is often titled "receiver manager."

In practice, a large receivership looks very much like a bankruptcy in that virtually all the borrower's assets have come under the receiver s control to be dealt with according to his mandate.

In these situations, the claim of the secured party who has caused the receiver to be appointed is usually so large that, on a liquidation, there is little money left over to satisfy the claims of ordinary creditors.

A general creditor may improve his position somewhat by suing his debtor and taking a judgment. Once he becomes a judgment creditor he is entitled to obtain an order directing the sheriff to seize and sell particular items of the debtor's property to satisfy the judgment. Even though he has taken judgment he remains a general creditor if a bankruptcy or insolvency should intervene before the execution process is complete. He may also be required to share the fruits of the execution with other general creditors under the terms of the *Creditor Assistance Act* if the provisions of that Act are invoked in a timely fashion.

A feature which is common to all three of these creditor's remedies is a respect for the property rights of others. The person who asserts a mere personal claim against a debtor is vulnerable to the other creditors who may invoke these remedies, but if a person can point to a particular item of property in the hands of the debtor, or in the hands of the trustee, receiver or sheriff who may assume control of the debtor's property, then that person can successfully assert a claim to that property to the exclusion of all other creditors. Thus, the person who lends his automobile to a debtor has a right to recover it even though the possession of that automobile may now be with the trustee, receiver or sheriff. Similarly, if money is given to a debtor in trust, the beneficiary can, so long as it can be identified or traced assert rights to the money which prevail over the claims of other creditors. It is in this legal context that the three Action Line complaints should be considered. Of the cases described in Chapter I only in the bracelet case was the consumer able to obtain any relief. She succeeded because a specific item of goods had been identified by the parties as the subject matter of the sale. As a result, certain property rights in the goods passed to the buyer, even though the goods remained in the possession of the seller to secure payment of the balance of the purchase price. This property right enabled the buyer of the bracelet to assert her claim successfully.

In the other two cases, similar property rights did not arise because no specific items of goods, then in existence, were identified as the subject matter of the sale. In the insulation case, it appears that the seller did, in fact, have a stock of insulation materials which would have been available to satisfy the seller's obligation to the buyer, had the insolvency not intervened. The difficulty arose because no specific items of this stock had, as a matter of the seller's internal procedures, been identified as goods destined for delivery to the buyer. In the bookshelf case, it appears that the sale was of goods to be manufactured to the buyer's specifications, which never, in fact, occurred.

In cases like the last two, where no property rights in goods came into being, the law regards the relationship between the buyer and seller as, essentially, one of creditor and debtor. The buyer's only right is to sue the seller either for the recovery of the money which he has paid or for other damages. This right is a hollow one when the seller fails to perform because he is insolvent. The buyer's recovery is likely to be, at best, a few cents on the dollar.

A more rigorous description of when property rights in goods come into being is set out in the following section.

It will be a rare consumer who has no experience with the sale of an item of merchandise. Most people have at least a basic notion of what a sale is. The commonest transaction is also the simplest. The buyer goes to the seller's place of business, indicates the item which he wishes to p urchase and tenders the purchase price to the seller. The seller gives the item to the buyer who takes it and goes on his way. The buyer now regards the item as his property and the seller regards the purchase money as his property. Both parties fee I fairly sure they know what their rights are and in most cases they are correct. Everything is simple and straightforward.

From a legal perspective, what has occurred is also relatively straightforward although not so simple as the consumer might think. Analytically, the conduct of the parties constitutes a contract between the buyer and seller. There has been an offer by the buyer to purchase t he goods and an acceptance by the seller, resulting in a complete and enforceable contract. The buyer, by tendering the purchase price of the goods has performed his obligations under the contract. The seller, by delivering the goods to the buyer, has performed his obligations. The result is that the seller's property rights in the goods have been transferred to the buyer under the terms of the contract. All of this may occur without any documentation coming into existence or, indeed, without any words being uttered by either buyer or seller. If all contracts of sale were this straightforward the body of law needed to regulate them would be equally so. It takes little imagination, however, to conceive of other elements which may turn a relatively straightforward transaction into one which bristles with complexity and raises difficult questions as to the rights of the parties. For example, the buyer may agree to take delivery of the goods at a later date, the seller may agree to accept payment at a later date, the payment may be made through a credit card issued by a third party or by a cheque drawn on a third party, the goods may have been delivered to the buyer on approval, the goods delivered to the buyer may not con form to his expectations, or numerous other variations or complications may arise. Fortunately, the law provides a clear answer in most situations and most of this law is to be found in the *Sale of Goods Act.*

Those provisions of the *Sale of Goods Act* which are of concern to us in the context of this study are those which tell us when a buyer acquires property rights in or to goods, as opposed to mere personal rights against the seller. The *Sale of Goods Act* is also relevant in establishing a framework of terminology to be used in discussing these rights and their possible modification.

At the heart of the Act is a provision which tells us what a sale is. Section 6 provides:

6. (1) A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a money consideration, called the price.
(2) There may be a contract of sale between one part owner and another.
(3) A contract of sale may be absolute or conditional.
(4) Where under a contract of sale the property in the goods is transferred from the seller to the buyer, the contract is called a sale; but where the transfer of the property in the goods is to take p lace at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell.
(5) An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred.

Although the terms "buyer" and "seller" are defined in the Act, those definitions do not depart from ordinary usage.

Section 8 of the Act confirms that a contract of sale calls for no special formalities:

8. Subject to this Act and any Statute in that be half, a contract of sale may be made in writing, either with or without seal, or byword of mouth, or may be implied from the conduct of the parties...

The *Sale of Goods Act* recognizes different states of "identifiability" of goods which may be the subject matter of a sale. Goods may be "specific goods." That term is defined in the Act as follows:

"specific goods" means goods identified and agreed on at the time a Contract of sale is made;

One may also have “unascertained goods.” This expression is not defined in the *Sale of Goods Act.* It is partly self-explanatory and, in part, takes its meaning from the context in which it is used in the Act. Generally speaking any goods sold which are not “specific goods” are “unascertained goods.” The goods may also be “future goods.” This expression is defined as part of section 9(1):

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

The term “future goods” is used in contradistinction to “existing goods.” “Future goods” and “existing goods” may be either “specific” or “unascertained.”

What the buyer acquires when he purports to buy goods depends on the category into which they fall. If the goods are “existing specific goods” he may immediately acquire a right of property in those goods. In other cases, the contract with the seller operates as an agreement to sell the goods. No property in unascertained goods can pass to the buyer. Section 21 of the Act provides:

21. Where there is a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer unless and until the goods are ascertained.

Even where a sale is of specific goods, or of previously unascertained goods which have become ascertained, prop erty in the goods will not necessarily pass to the buyer. The property right passes only when the parties intend it to pass. Section 22(1) of the Act provides:

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

The *Sale of Goods Act* provides a number of rules which provide guidance in determining the intention of the parties within the meaning of that section. These are found in section 23 of the Act and those which are most important for our purposes are as follows:

23. (1) Unless a different intention appears, the intention of the parties as to the time at which the property in the goods is to pass to the buyer is governed by the rules set out in subsection (2)to (7).

(2) Where there is an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer when the contract is made and it is immaterial whether the time of payment or the time of delivery, or both, be postponed.

(6) Where there is a contract for the sale of unascertained or future goods by description, and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer, or by the buyer with the assent of the seller the property in the goods thereupon passes to the buyer. the assent may be express or implied, and may be given either before or after the appropriation is made.

The three cases which were described in Chapter I may usefully be analysed in terms of the Act. The bracelet case concerns existing specific goods. The subject of the sale appears to have been identified and agreed on at the time the sale was made. Under section 23(2) the intention of the parties is taken to be that property in the bracelet passed to the buyer at the time the contract was made, even though possession by the buyer and payment (in part) of the purchase price were postponed. The subject matter of the insulation case appears to be existing unascertained goods. Under section 21, no property interest in them could arise in favour of the buyer until they had become ascertained. Had the seller's insolvency not intervened, in due course, particular items of insulating materials would have been appropriated to the sale under section 23(6) and at that time enforceable property rights in the buyer would have arisen.

In the bookshelf case the goods were also unascertained, but these were future goods to be manufactured. It appears that no goods ever came into existence in which property could pass to the buyer. In cases such as this the normal rule is that property cannot pass to the buyer until the goods are completed and in a deliverable state, although it is open to the parties to agree that property will pass to the buyer at an earlier stage.

CHAPTER III

The insulation case and the bookshelf case, discussed in Chapters I and II illustrate the kind of situation which deserves further consideration. It is difficult not to sympathize with the buyers. In one case, goods which might ave been used to complete the sale transaction remained in the possession of the seller (or his successor in interest) but they could not be made available to the buyer. Moreover, in either case the money p aid by the buyer may have continued to sit in the seller's bank account, but was equally inaccessible to the buyer. In each case, the buyer had conferred a benefit on the seller which likely ended up being used to satisfy other claims on the seller -- claims in which the buyer was totally disinterested. Is there a good case for improving the legal position of the buyer in these circumstances.

On one view, no action is called for. It might be argued that these cases and others like them merely reflect the operation of a more general set of rules designed to promote equality among creditors in the case of an insolvency and which, on the whole, operate satisfactorily. The same retail merchant who has left his prepaying customers in the lurch may also have incurred other debts immediately before his insolvency. For example he may have accepted delivery of goods from a wholesale supplier on 30 day terms and borrowed money from a commercial lender. The goods supplied by the wholesaler and the borrowed money, both become the property of the merchant. If he becomes insolvent before payment is due, the status of these credit grantors is also that of unsecured creditor. The value which they have given may be used towards satisfying the claims of others, including, perhaps, prepaying customers. A person in the position of the wholesaler might well argue that if the prepaying customer has any claim for stronger rights to repayment so does the wholesaler and a multitude of others. Attempting to recognize all such rights achieves nothing. Given a limited pool of assets available for distribution, any advantage enjoyed by one creditor operates to the detriment of competing creditors and any attempt to give an advantage to everyone gives an advantage to no one.

The argument in favour of the present position would conclude that, while an examination of recoveries in an insolvency which focuses on the position of particular creditors may give an appearance of unfairness, a broader perspective reveals that the present system achieves a result which, overall, is not unfair. In any insolvency, losses to general creditors are almost inevitable and the best the law can do is see that these losses are borne fairly.

The argument against reform has considerable force, but there are a number of factors which suggest that an enhanced status for the buyer of consumer goods who prepays his seller is appropriate.

The consumer buyer who prepays a retail merchant for his goods, and the wholesaler who has supplied that merchant's inventory without being paid for it, have both extended credit to the merchant. Their motives for doing so, however, are quite different. The wholesaler extends credit in order to make a sale of the inventory and to realize a profit on that sale. The extension of credit may induce the merchant to do business with that wholesaler rather than one of the wholesaler's competitors. The extension of credit is expected to result in some financial advantage to the wholesaler. The same is true of the commercial lender who advances funds to the merchant. That loan will normally attract interest which is the lender's profit.

The profit motive is absent when a consumer buyer extends credit to a seller in the form of a prepayment. In most cases, the buyer does not even think of it as an extension of credit and it is difficult to identify any motive with his conduct, much less a profit motive. He sees it simply as a normal part of the transaction. This assessment is usually accurate.

It is arguable that this difference in motivation is significant in this context. It provides support for a legal position which places the person who expected to profit from an extension of credit at some disadvantage *vis* vis a person who extended credit without any such expectations.

Few business organizations will extend substantial amounts of credit in the absence of information which will assist them in assessing the risk of default by the borrower. Typically, a commercial lender or wholesaler will make some sort of inquiry, perhaps using the services of a credit reporting agency, to assess the credit worthiness of the prospective debtor. Armed with appropriate credit information, this person can then adjust his lending practices according to the risk as he perceives it. He may choose to minimize the risk, or to charge a higher price or interest rate to compensate for assuming a higher degree of risk.

The consumer buyer is simply not equipped to bring these kinds of considerations to bear. He normally does not have access to the services of a credit reporting agency and, even if he did, it would seldom occur to him to use them. Again, the distinction rests on the fact that the consumer buyer does not characterize his prepayment as an extension of credit. The risk of the creditor's insolvency is simply not a consideration with him, nor is there any reason why it should be. This contrast with the position of the commercial creditor may justify differing treatment.

Apart from accurate credit information, there is another technique available to the commercial creditor to minimize his risk. He may demand that the person to whom he is extending credit provide a security interest in the borrower's property. That property may include goods supplied by the creditor or it may include other property already owned by his borrower. Thus, the wholesaler who supplies inventory on credit may do so through a conditional sale agreement under which the wholesaler retains "title" to the goods to secure payment of the purchase price. The commercial lender may demand a mortgage of property which the borrower now has, or which he may acquire in the future.

The creditor who uses these techniques lifts himself out of the class of general creditors. Subject to complying with certain formal requirements, and in the absence of any competing creditors who have taken a similar security interest in the same property, that creditor has an exclusive right to look to the property in which he has acquired a security interest for repayment, to the exclusion of all the borrower's unsecured creditors. If he has taken adequate security, such a creditor may realize the full value of his indebtedness while the unsecured creditors get but a few cents on the dollar.

Taking consensual security to safeguard a p repayment for goods is a technique which, realistically speaking, is not open to the consumer buyer. The realities of the market place do not permit him to bargain for protection of this kind.

A final factor which argues for a special position for the consumer buyer who has prepaid, is that his rights of recovery may depend on fortuitous circumstances over which he has no control. For example the seller may have a stock of goods, any item of which might be sold to the buyer. Whether or not the buyer has any rights, beyond those of an unsecured creditor, will depend on whether or not a particular item or items of the stock have been identified by the seller as the subject matter of the sale. This in turn will depend on the kinds of internal procedures which the seller may have developed concerning goods in these circumstances. These procedures may more often reflect concepts of efficient management rather than a concern with the buyer's property rights.

To give an example, two different outlets of the same appliance dealer may adopt slightly differing practices in relation to their deliveries. The procedures of outlet number 1 may require that as soon as a sale is made on "the floor" an item is taken from stock at the warehouse area of the store, tagged with the name and address of the buyer, and then moved to the truck loading area. The seller's documents evidencing the sale are then returned to the outlet's accounting arm and all delivery information is compiled from the particulars on the tags. The procedures in out let number 2 may be slightly different. Here, a copy of the sale invoices are sent directly to the delivery arm where lists are prepared of what is required to be taken from stock for delivery *(e.g.* 10 of item X; 4 of item Y; and 6 of item Z).

What happens if an insolvency intervenes to prevent delivery in these cases? With respect to outlet number 1, it is probably safe to assume that the goods are identified as being the subject matter of the sale as soon as they are tagged. So long as that occurs before the insolvency, the buyer is protected. The situation is much less clear with respect to outlet number 2. If there are a large number of similar items to be delivered, it may be that the subject matter of the sale is not identified until the delivery van has arrived at the buyer's home and the driver has selected one carton in preference to another. There is a very distinct possibility that a buyer from outlet number 1 will be in a much stronger legal position than a buyer from outlet number 2 purely as a result of the internal administration of the seller's business.

The arguments outlined above are basically those set out in the Working Paper. The provisional view reached in the Working Paper was that the arguments favouring change were to be preferred. This formed the basis of a tentative conclusion that reform measures of some kind were called for.

The submissions which the Working Paper attracted, to the extent that they addressed the basic issue, set out arguments which proceeded along the general lines adumbrated in the Working Paper. We are not persuaded that a retreat on the basic issue is called for.

We find the arguments in favour of a special position for the prepaying consumer persuasive. There is a real distinction between his position and that of the commercial creditor. The commercial creditor extends credit with a profit motive in mind; he is in a position to acquire accurate information and weigh his risks carefully; he is able to extract higher prices or interest rates to compensate for that risk; he is able to spread his losses efficiently among others with whom he does business, and he may be in a position to extract security to minimize his risk.

None of these avenues is open to the consumer creditor who has made a prepayment. The paradigm involves a person who, on Monday, buys and pays for a refrigerator, of a certain make and model, to be delivered on Wednesday. The possibility that his seller might become insolvent on Tuesday does not enter his mind. Even if it did, the market place for consumer goods does not offer him any realistic way of protecting his position. If he attempted to improve his position with the kind of techniques available to commercial creditors, he would only invite ridicule. Whether that buyer ends up with his refrigerator, or with a dividend for a few cents on the dollar as an unsecured creditor, may well turn on the internal procedures used by the seller in identifying goods for delivery.

It is our final conclusion that these distinctions justify an enhanced legal position for the buyer in these circumstances and that it is appropriate to modify the law accordingly.

CHAPTER IV

To refer to "an enhanced legal position" for the buyer of consumer goods in the circumstances under consideration, is to state our goal at the highest level of generality possible. To state it is immediately to raise questions respecting the extent to which the legal position should be enhanced and the legal techniques which should be used. In this area there are few precedents and those that exist are less than satisfactory. Much of the Working Paper was, therefore, devoted to an examination of the legal tools at our disposal which might be wielded in pursuit of our goal. Our deliberations in this regard turned out to be a two-stage process.

The first stage was to explore changes in the *Bankruptcy Act* as a possible vehicle for reform.

The most direct way of achieving an enhanced legal position for the buyer of consumer goods who has prepaid, but not taken delivery, is to give him a special status under the *Bankruptcy Act* which would identify his claim as one to be preferred over competing unsecured creditors. There is ample precedent for giving certain classes of otherwise unsecured claims a preferred position, an obvious one being the special recognition given the claims of unpaid workers for arrears of salary or wages. While this course has the advantage of simplicity, there are a number of factors which militate against it. First, the matter of bankruptcy and insolvency is one on which only the Parliament of Canada can legislate. It is not open to us, as a provincial law reform agency to recommend changes in the *Bankruptcy Act.* The furthest we could go would be to recommend that the provincial government make representations to the federal government that such changes would be desirable. In fact, reform of our bankruptcy laws has been under consideration by the Federal authorities for almost 17 years. This process has involved a number of forms of consultation, including the introduction of several “exposure Bills” into the Senate and House of Commons, which have then been permitted to lapse. None of the proposals for new bankruptcy legislation has evinced any concern with consumer buyers, and the tendency of bankruptcy reform has been toward decreasing the number and classes of preferred creditors rather than increasing them.

The process of bankruptcy reform has crystallized to the point where the introduction of a new concept would be difficult, particularly when that concept is inconsistent with many of the changes sought to be achieved by that reform.

There are other reasons which support a conclusion that changes to the *Bankruptcy Act* are not a complete answer in this context. In many insolvencies the provisions of the *Bankruptcy Act* are never invoked. None of the three examples in Chapter I involved a formal bankruptcy. The most common example of the administration of an insolvent estate outside of bankruptcy is the administration by a receiver who has been appointed at the behest of a secured creditor. The priorities set out in the *Bankruptcy Act* do not necessarily bind a receiver.

The existence of secured creditors is a further reason why we believe that modifications to the *Bankruptcy Act* would not be an appropriate vehicle for reform. The present Act, and all proposed drafts, recognize and give full effect to the claims of secured creditors to property in which they have taken an interest. While such claims, of course, should be treated with the greatest respect, we are not convinced that their rights should prevail over the consumer buyer in every conceivable case. The factors outlined above led us to reject changes in bankruptcy law as an appropriate vehicle for reform. This led us to a consideration of the constitutional powers of the province to create and define interests in property.

The province has the power to legislate with respect to property and civil rights and it is well accepted that our federal bankruptcy laws take the property laws of individual provinces as they in hem. For example, the *Bankruptcy Act* provides a mechanism for calling in and distributing the property of the bankrupt. Precisely what it is that constitutes the property of the bankrupt, however, is determined with reference to the applicable provincial laws, unless a specific provision of the *Bankruptcy Act* dictates a different result. Such laws include legislation in relation to sale of goods and the general law in relation to the recognition and enforcement of trusts.

It is our conclusion that the only reform strategy open to the Province that is capable of giving a remedy to the buyer is to create a structure of property rights. These rights would come into existence when a prepayment is made and their enforcement could provide a measure of relief if the seller defaults. A more detailed analysis from a constitutional perspective is set out in Chapter IX of this Report.

CHAPTER V

If the buyer who prepays for consumer goods is to be given some kind of enforceable property rights, to what property should those rights attach. While it would be possible to create property rights in all of the seller's assets, this would not necessarily result in a fair or workable solution. We believe it is possible to create a reasonable and practicable scheme of rights for the buyer by focusing on two types of assets which are most closely connected with the contract of sale. The first asset is the purchase money itself. The second asset is goods in the possession of the seller which might have been appropriated to the sale but which were not because of intervening events.

The notion that the consumer who makes a prepayment might retain some kind of property interest in it is not a new one. A property interest can arise under the present law. It may be based on the conduct of the buyer or the seller, or it can arise by operation of law in certain circumstances. When a property interest does exist, it usually involves the purchase money being characterized as trust money, with the seller or supplier as trustee and the buyer as beneficiary. Where money is characterized as trust money the law regards the beneficiary of the trust as the true "owner" of the money and gives him the right to recover it if the purposes for which the "trust" was created fail.

It is open to the buyer to create this trust relationship himself at the time the prepayment is made. In one instance drawn to the Commission's attention, the buyer was dealing with a mail order supplier, who demanded payment in advance. The payment was made with a cheque marked" in trust" and the letter which accompanied it stated:

> The terms of the trust imposed are simply that the proceeds of the cheque will be held by you in trust or me, according to good practice relating to the custody of trust monies, until the goods are place in the custody of the carrier for delivery to me. When that has been done you are free to appropriate the proceeds of the cheque in satisfaction of my obligation to you.

In this case the transaction was properly completed. But if an insolvency had occurred, the buyer would have had the right to claim the trust money, to the extent that it was identifiable, to the exclusion of other creditors.

It also appears that it is open to the seller to create a trust with respect to prepaid money, even if the buyer had not characterized the prepayment as creating a trust. An example is to be found in theE nglish case of *Re Kayford Ltd.* In that case the seller was a mail-order supplier which encountered financial difficulties. Being concerned for its customers who prepaid for goods, the company reactivated a dormant bank account which it designated as a "customer's trust deposit account." All prepayments received after the designation of the account were paid into it. It was the seller's intention that, should it be forced into liquidation, those sums could be refunded to the prepaying customers who had sent them. The company was, in fact, forced into liquidation and it was held that a valid trust had been created for those buyers whose prepayments had been paid into the account. This trust was effective as against the general creditors.

Unless either the buyer or the seller has taken some positive step from which the existence of a trust may be inferred, the courts will usually be reluctant to hold that a prepayment, *per se,* creates a trust.

An example of a statutory scheme regulating prepayments and creating a structure of trust rights is to be found in sections 22 to 25 of the *Consumer Protection Act.* The prepayments which are the subject of these provisions are not in respect of goods, but in respect of "future services," a term defined to include things like contracts for dance lessons and contracts for health studio services. The basic scheme of these provisions is that all prepayments received by the supplier are to be paid into a designated trust account against which the supplier may draw as the money is deemed to be earned. The legislation specifies that money so held "continues to be the beneficial property of the buyer" and "is not subject to attachment for execution against the seller." These provisions have not yet been proclaimed into force so no case law has emerged to illustrate how they work in practice.

A common factor in the three trust situations described above is that the buyer's money is somehow to be held separate and apart from other money belonging to the supplier. While a separate holding of trust money is not an essential feature of an effective trust, where that is not done practical problems can arise in determining whether an effective trust has been created.

Is the trust an appropriate vehicle for an effective scheme of property rights in money which a buyer has prepaid? The balance of convenience seems to be against creating express trust rights in this situation. What weighs most heavily is the inconvenience which would result if every supplier who held prepayments, for however short a time, were forced to adopt elaborate accounting mechanisms to keep track of these prepayments and to hold them separately. It should be remembered that most prepayment situations will be ephemeral. An item is bought and paid for on Monday with an item of that type to be delivered from the seller's stock of such items on Wednesday. To require that this type of prepayment be treated as a trust would be to impose on every such transaction an administrative burden which far outweighs the benefit to individual buyers in the few cases where trust rights would be needed.

Our view is partially reinforced by the fact that the provisions of the *Consumer Protection Act* which embody an analogous concept with respect to future services have not been proclaimed into force a fter ten years on the statute book. We can only speculate why this has been the case but, given the complexity of the scheme, the administrative burden it places on suppliers would almost certainly be a factor.

It would not be necessary to adopt the *Consumer Protection Act* as a model in creating trust rights. It would be possible simply to deem the money to be trust money without imposing a requirement that it be held separate and apart, leaving the buyer to whatever rights he may have under the rules relating to "tracing" of trust money. This, however, has disadvantages both for the buyer and for the competing creditors. The buyer would be forced to provide evidence of a "chain" of dealings with his money to be finally able to point at an asset which is identifiable as its final proceeds. This may be an unrealistic evidentiary burden in a consumer context. The widespread use of third party credit cards adds an additional dimension of complexity.

Moreover, the tracing rules may lead to the identification of assets of a type which ought properly to be available to the general creditors. For example, if the seller takes the prepaid purchase money and uses it to buy an office typewriter, should the buyer have an exclusive right to that typewriter? It is at least arguable that once the prepayment has ceased to take the form of money or an account in which money has been deposited, the buyer s rights should be cut off.

Later in this chapter we will return to the issue of the kind of interest the buyer should have in the prepaid purchase money. Before doing so, however, it is helpful to explore some of the issues which arise in relation to giving the buyer rights in goods.

Earlier in this chapter we concluded that it would be useful to reinforce the buyer's position by giving him a claim on tangible property, if such a claim can be justified in terms of principle. Goods which are part of the seller's inventory and which might have been delivered to the buyer had an insolvency not intervened, should be amenable to a claim by the buyer.

In examining the possibilities it is helpful to do so within the framework of an example:

The buyer purchases and pays for a refrigerator of model X. No particular refrigerator of model X has been identified although the seller has 12 such refrigerators which are part of his inventory stored in his warehouse. It is arranged that one of these refrigerators will be delivered to the purchaser's home the following day, but before any particular refrigerator is identified as that purchased, the seller becomes insolvent.

This is a classic "unascertained goods" situation. The buyer has no enforceable property rights in any particular refrigerator or in the whole mass of refrigerators. How might such a right be created?

One approach might be to deem a refrigerator to have been appropriated to the sale as soon as the contract of sale came into existence. This approach immediately raises the question of which of the 12 refrigerators has been appropriated to the sale. To answer this question it would be necessary to go a step further and create one or more presumptions which would provide guidance in identifying a particular refrigerator. If the refrigerators bear manufacturer's serial numbers, one might deem that which bears the highest (or lowest) serial number to be the one to be appropriated to the sale. If the goods do not bear serial numbers, then appropriation might be defined with reference to other factors such as physical proximity to the buyer at the time payment is made.

There are a number of objections which can be taken to the approach described above. First, it has a decidedly arbitrary flavour. It would require extensive reliance on presumptions and fictions which are unrelated to the realities of the transaction. Second, this approach leaves too much latitude for other interests to arise and creates difficult competitions for priority. While we are under no illusions that priority competitions can be avoided, we do believe that they can be minimized. This approach does not minimize them.

The kind of competition which might arise under a deemed appropriation is one with a subsequent buyer who takes possession of the goods. Given the example, what if a refrigerator with serial number 1234 was deemed to be appropriated to the sale. What are the rights of the parties if, an hour later, a second buyer purchases a refrigerator of a similar model, but instead of arranging with the seller to deliver it, proceeds to the warehouse to pick it up himself and receives number 1234? An insolvency then intervenes and a question arises as to the rights of the parties. There are two possible outcomes. The first is that the original buyer is able successfully to assert his property rights against the second buyer and claim possession of the refrigerator. In that case the second buyer, an equally innocent party, may suffer. A more probable outcome is that the second buyer can successfully assert his rights as against the original buyer. Section 58(1) of the *Sale of Goods Act* provides:

> 58. (1) Where a mercantile agent is with the consent of the owner, in possession of goods or of the documents of title to goods, any sale, pledge or other disposition of the goods made by him when acting in the ordinary course of business of a mercantile agent is, subject to this Act as valid as if he were expressly authorized by the owner of the goods to make the same, if the person taking under the disposition acts in good faith, and has not at the time of the disposition notice that the person making the disposition has not authority to make the same.

The likely effect of this section is to permit the seller to pass good title to another buyer, in goods which had been deemed to have been appropriated to the sale to the original buyer. In this situation the original buyer is no better off than under the present law and still has no rights in any other refrigerators in the seller's inventory, unless one were to go on and specify for a second deemed appropriation where the first one proved to be ineffective.

A more promising approach might be to deem that all 12 of the refrigerators in the inventory are appropriated to the sale, such that the buyer ends up as the owner ofan undivided interest, as a tenant-in-common, in the mass of refrigerators, the extent of his interest being defined with reference to the number of units held in inventory and the number he has purchased. The buyer might, thus, end up as the owner, as a tenant-in-common with the seller (and perhaps with similar buyers) of an undivided one-twelfth interest in a mass of twelve refrigerators.

Complications, however, could quickly arise. What of the second buyer referred to in the example above? Does the original buyer end up with an undivided one-twelfth interest in 11 refrigerators? What if the same model of refrigerator is sold to 20 different buyers when only twelve such models are available as part of the inventory? This could easily occur where the seller honestly expected to acquire further refrigerators from a wholesale distributor, but the insolvency intervened before he could do so. To deal with these kinds of problems, it would be possible to create a host of sub-rules, but the end result would be a very complex form of "ownership." Moreover, "ownership" would become a misleading term to apply to the bundle of property rights which the buyer would have in this situation. His rights would be not unlike those he would have if his rights were simply characterized as a lien over the mass of refrigerators. This, it seems to us, points the way to the correct approach.

A lien is one type of "security interest." Modern personal property security legislation defines security interest to mean an interest in property "that secures payment or performance of an obligation." In the example under consideration, the seller's obligation is to provide a refrigerator to the buyer or, if the seller is unable to do so, to refund the prepayment. If the buyer were given a lien over all twelve refrigerators, it would be to secure that obligation. The obligation would be discharged and the lien would vanish once the seller had performed his obligation.

If an insolvency intervenes before the seller performs his obligation, the security interest does not disappear. It would be up to the successor of the seller, such as a receiver or a trustee, to see that the lien is discharged before dealing with the goods for the benefit of persons other than the buyer. This might be done by completing the seller's part of the bargain and appropriating a refrigerator to the sale, in which case the buyer's rights are preserved. Alternatively, the mass of refrigerators may be liquidated and the lien claimant p aid from the proceeds realized. This might be done when there are more claimants than refrigerators. It is not only tangible personal property that may be amenable to a lien. One can also have a lien on intangible property. It follows from this that the same legal technique identified as appropriate for creating a buyer's rights in goods may also serve to create rights in the prepaid purchase money. The most pragmatic approach to the creation of a remedy in this context is to give the buyer a lien on any deposit account into which the seller, in the usual course of his business, pays the proceeds of his retail sales. This approach has the advantage of imposing no particular accounting requirements on the seller and would eliminate the need for the buyer to establish the evidentiary chain which confirms payment into a particular account.

In the Working Paper, we tentatively concluded that the lien was the most appropriate legal concept on which to build a framework of buyer's rights. We suggested that the lien approach had the virtue of simplicity, when compared to the alternatives. We also pointed out that it avoids legal fictions and provides a familiar context for recognizing and dealing with competing property interests which may arise.

Not every correspondent that commented on the proposals in the Working Paper addressed the issue of the appropriate legal concept that might be employed in developing an appropriate remedy. Some were hostile to the creation of a remedy of any kind and did not comment on whether the lien approach, as opposed to some alternative, would be preferable.

Of those correspondents who did address this issue, a majority appeared to favour the approach adopted in the Working Paper. One commentator (who did not, ultimately, endorse the Commission's proposals) observed:

> In terms of law reform, I have some sympathy for the proposals set out by the working paper. The buyer's position is indeed difficult when he has pre-paid and has no rights against the goods by virtue of the *Sale of Goods Act.* Further, I think that giving the buyer a lien would be the only practicable way to protect his rights. Establishing beneficial rights to the purchase money seems unduly complicated and would impose distinct accounting burdens upon sellers. The additional cost and inconvenience imposed on sellers likely would end up being passed on to the buyers in the form of a higher price. r egarding the passage of property is the way to protect buyers. The rules regarding the passage of property already are difficult enough without partially altering them to accommodate a particular class of buyers. These rules arguably need wholesale revision. They do not, however, need tobe made more complicated than they presently are.

The need for a scheme which would "not alter the accounting, banking, or any other day-to-day procedures of retailers" was echoed by a group speaking on behalf of retail sellers.

Nothing in the submissions received has persuaded us that a departure from the basic approach adopted in the Working Paper is called for. The tentative view in the Working Paper, that the buyer's lien is the most appropriate vehicle for the creation of a remedy, retains its force as our final conclusion. In the next chapter we will consider, in greater detail, the characteristics of the buyer's lien.

CHAPTER VI

The previous chapter endorsed the concept that a lien should arise, by operation of law, to reinforce the rights of certain buyers. The buyers who would benefit are those who have paid for consumer goods but have not acquired any property in specific goods. The lien would attach to two types of asset. The first would be the mass of goods in the seller's inventory, any item of which meets the description of the goods which are the subject matter of the sale. A second type of asset subject to the lien would be the deposit account into which the proceeds of retail sales are deposited by the seller in the usual course of his business. For convenience hereafter in this Report we shall refer to this lien as the "buyer's lien." The purpose of this chapter is to describe with greater particularity the characteristics of the buyer's lien and the legal context within which it might operate.

An issue raised in the Working Paper was the complexity and level of detail that should be embodied in a buyer's lien scheme. The actual proposals set out in the Working Paper were the end product of an evolutionary process which started with a group of extremely detailed and arguably, complex proposals. Our earliest drafts raised very squarely the issue whether it was necessary to develop a scheme of this kind in the detail that one might devote to a reform package aimed solely at the commercial community. We were greatly concerned that the increased certainty achieved through detailed proposals did not outweigh the loss of simplicity involved.

We therefore set about recasting our original proposals into a much reduced and highly simplified core. In the Working Paper, we described our approach and called for comment on it in the following terms:

> In developing the proposals...we strove for simplicity. This is reflected in two ways. First, we have tried to keep the number of features embodied in the proposed scheme as few as possible. Second, we have tried to keep the drafting of our proposals relatively straightforward.
>
> In taking this approach we were motivated by a view that in the vast majority of cases the application of provisions which embody he buyer's lien will e by persons other than lawyers. In the usual case, at most there will be a few hundred dollars at stake (usually much less) and this is seldom the stuff of which superior court litigation is made. The framing of our proposals, therefore, reflects our view that the constituency at which they are aimed will be better served by simpler concepts.
>
> Not all, however, may agree with this approach. What may seem to be admirable simplicity to one person may be a lamentable lack of rigour to another. If one were to retreat from the simplified approach a number of refinements to the proposaIs would be possible. They could, for example provide guidance on the mechanics of enforcing the buyer's lien, and provide definitions of key terms....
>
> Comment is specifically invited on whether this approach is satisfactory or whether if we adhere to the general policy of our proposals, the drafting of our final recommendations should reflect a somewhat more detailed approach.

Our correspondents did not hesitate to respond to this invitation. The mood of the response was clear. Most of those who commented saw a need for greater rigour in the development and description of the buyer's lien scheme. The approach we take in this Report is to express our recommendations in the form of draft legislation which is set out in Chapter VIII. In this way, we will be able to address issues and points of detail left untouched by the proposals in the Working Paper. We hope, in the result, that our recommendations will be suffused with a degree of rigour that will meet the concerns of most of our correspondents. At the same time, the format of legislation should give the scheme a structure which makes its approach less formidable than might otherwise be the case.

In the Working Paper, the basic proposal for the buyer's lien was set out in the following terms:

A buyer of goods who has made a prepayment in respect of the purchase price, should have a lien (hereafter "buyer's

(a) any account in a savings institution in which the seller usually deposits the proceeds of retail sales and
(b) all the setter's goods that meet the description of the goods sold;

until specific goods are appropriated to the sale, or the prepayment is refunded to the buyer.

The lien described would provide a significant addition to the rights of the hypothetical refrigerator buyer in the example in the last chapter. Upon paying the purchase p rice a lien would attach to two types of asset. The first would be the deposit account in which purchase-money is usually deposited. The second would be all the refrigerators of model X which the seller may have in his inventory. This is the buyer's lien which arises under the proposal.

The lien secures a refund of the prepayment, or the appropriation of specific goods to the contract. It should be noted that the lien does not secure the actual delivery of goods to the buyer. The proposal stops short of that. This reflects the principal concern which is simply to create a structure of property rights which are enforceable, as may be necessary, against the seller or his successors.

Under the proposal the buyer's lien could be discharged either by the appropriation of goods to the sale contract or by a refund of the prepayment. This led one correspondent to query whose wishes should govern when there is a dispute between the buyer and the seller (or his successor) as to whether the buyer's relief should take the form of a refund or of rights in specific goods. It seems clear that if goods are available to be appropriated to the sale, the seller is entitled to insist that the buyer accept an appropriation of them in discharge of the lien. The buyer would have no right to insist on a refund. Here the seller would merely be performing his obligations under the contract of sale. The reverse situation is more difficult. Should the seller (or more likely his successor in interest) be entitled to force a refund of the prepayment on a buyer who would prefer to have the goods (assuming they are available) appropriated to the sale?

Our preference is to give the seller or his successor a free hand in choosing which of the two methods is to be adopted to discharge the buyer's lien. If the seller is solvent, the buyer should be able to sue for, and recover, whatever damages that might flow from the seller's failure to perform his obligations under the contract. If the seller is insolvent then the buyer should count himself lucky to get anything at all and he should not be heard to complain too loudly if he gets money rather than goods. Moreover, the ability to choose the way in which a lien is to be discharged should give a receiver or trustee much-needed flexibility in administering the seller's property. Our draft legislation will reflect this policy choice.

Paragraph 1(b) of the proposal referred to "all the seller's goods that meet the description of the goods sold." It was intended that this encompass not only goods in the seller's inventory at the time the sale is made, but any goods meeting the sale description that the seller may subsequently acquire during the period the lien is in force.

The reference to "seller's goods" as the subject of the lien raised concerns in one submission that this created a "loophole" which sellers and their financers might exploit. The particular concern was that this formulation suggests that title to the property must be in the seller and, therefore, inventory financed through a type of security under which title rests in the financer *(e.g.,* consignment or conditional sale) might not be caught by the lien. A related concern was that elaborate schemes might be adopted involving multiple companies so that the legal entity with which the buyer deals is not the same legal entity that owns and would be responsible for delivering the goods.

The first concern is one which can be met through appropriate drafting. The other concern can be addressed at two different levels. First, it is not clear that an evasive scheme of the kind suggested would necessarily be effective. Principles of agency law could readily lead one to the conclusion that the owner of the property is also the seller and that the property is subject to the lien.

Second, it should be remembered that elaborate schemes of evasion would involve active steps by the seller. In reality, there is little to induce the seller to complicate the way be conducts business by operating through multiple companies when the only beneficiary will be the seller's creditors. It is true that a major creditor may be able, to a degree, to dictate how a debtor will carry on business. It is difficult, however, to see a creditor requiring his debtor to go to these lengths merely to eliminate a class of potential claimants whose claims would likely be *de minimis* in any event.

There is one evasive technique which would be relatively easy to implement and deserves specific consideration. A correspondent raised a concern that a likely reaction to legislation creating a buyer's lien would be to ensure that contracts of sale contain some kind of waiver by the buyer under which he gives up his lien rights. It was suggested that waiver be prohibited. We agree. The general tendency of most consumer protection legislation is th at the rights given by it should not be capable of being waived. Given this characterization of our scheme, we can see no reason for treating it differently and our recommended legislation addresses the issue of waiver.

In the Working Paper, the basic description of the buyer's lien was supplemented by a further proposal which defined the circumstances in which it would be available:

A buyer's lien should arise only on a sale of consumer goods made in the usual course of the seller's business.

The most significant point to be noted is that this proposal confines the lien to transactions involving a sale of consumer goods." This reflects our view that the new remedy is one primarily for the assistance of the consumer buyer who is least able to safeguard his interest in the marketplace.

By "consumer goods" we mean goods that are acquired by the buyer for use primarily for personal, family or household purposes. Several of our correspondents suggested that it would be helpful if a definition of consumer goods was provided and this suggestion has been incorporated into our draft legislation in Chapter VIII.

A final point to note is that the sale must be in the usual course of the seller's business. This means, essentially, that private sales of consumer goods will not give rise to a buyer's lien where a prepayment is made. The reality is that private sales seldom give rise to problems since specific goods are almost invariably appropriated to the sale at the time the agreement is made.

The discussion under the previous heading attempted to describe, in a general way, the nature and character of the buyer's lien, but it made no attempt to describe the relationship between that lien and other interests in the goods that may arise. These may include the interests of a mortgagee or other secured party, of a second buyer of the goods or another buyer holding a similar lien. Any consideration of the priority strength which should be accorded the buyer's lien, insofar as it attaches to goods, necessarily involves a consideration of who the competing parties are and the relative strength of their various claims in comparison with those of the buyer.

The type of competing creditor who will most frequently emerge in a priority contest with the buyer is the secured creditor. This will be a person who has extended credit to the seller and taken an interest in the goods to secure repayment. A competing secured creditor may be a commercial lender who has advanced money to the seller and taken a security interest, say in the form of a mortgage, over all of the seller's inventory (including the refrigerators, to stay with our example).

The creditor may also be a member of a particular class of secured creditors who hold what is sometimes referred to as a "purchase-money security interest." The latter is the lender or supplier who provided the credit which enabled the seller to acquire the property in which the security interest is claimed. An example would be a wholesaler who supplied the refrigerators to the retailer under a conditional sale arrangement, or the financer who lent money to the supplier for the specific purpose of acquiring the refrigerators. As a general rule, purchase-money secured parties enjoy priority over most other competing claims.

A detailed discussion of the rights of secured parties is beyond the scope of this Report, and is complicated by the existence of two separate legislative schemes designed to regulate them. One such scheme is in force at the present time and the other is likely to replace it in the near future. The body of law presently in force is that set out in four different Acts which regulate security interests in personal property. Awaiting enactment is new personal property security legislation. which will replace the existing statutes with a new and modern legal framework. The principal concerns of both of these bodies of law are security interests which are created by agreement between the parties. Neither purports to extend to liens which arise by operation of law. In both cases, priority competitions between liens which arise by operation of law and consensual security interests regulated by statutes aimed at such transactions, must be determined on an *ad hoc* basis subject to any guidance that may be derived from legislation concerning particular liens.

An established feature of both bodies of law is that where a merchant sells goods in the usual course of his business, the buyer takes goods free of any security interest in them that the merchant may have given a secured lender. The *Uniform Personal Property Security Act* makes this explicit in section 28(1):

> 28. (1) A buyer or lessee of goods sold or leased in the ordinary course of business of the seller or lessor takes free of any perfected or unperfected security interest in the goods given by the seller or lessor or arising under section 27, notwithstanding that the buyer or lessee knew of it, unless the buyer or lessee also knew that the sale or lease Constituted a breach of the security agreement.

It is also made explicit in section 30 of the *Sale of Goods on Condition Act.*

With respect to other types of security interest, the protected position of the buyer arises out of judge-made law and may be based on section 58 of the *Sale of Goods Act,* quoted in the previous chapter, or through the court's finding that the security agreement contains an implied term which gives the merchant a licence to sell the goods free and clear of the lender's interest.

A question which must be confronted is whether the buyer's lien over good should prevail over the rights of secured parties who have taken a security interest in the sale of goods. The principal argument in favour of the buyer's priority is that the competing secured party was vulnerable to the buyer in any event. It is only an accident of timing which prevented goods from being appropriated to the sale which would have defeated the secured party's claim. In may be argued that for priority purposes it works no great hardship on the secured party to regard as done that which ought to have been done. To give the buyer's lien priority is no more than giving the buyer's rights the same recognition they would have received had he taken immediate possession of goods which he had paid for. Why should an accident of timing, or the particular nuances of the merchant's internal procedures for appropriating goods, result in a windfall to the secured party -a secured party who may also have a claim on the purchase-money as "proceeds" of the goods?

Arguments also exist which suggest that the secured party should be entitled to priority. From the secured party's point of view, he has done all that he can to create and protect a property interest in the goods. To diminish the value of the interest he has acquired is to significantly erode the credit granting machinery which is vital in a modern economy. In some cases, a priority for the buyer might also work actual hardship, particularly where a small manufacturer or wholesale supplier has made available, but has not been paid for, the very goods being claimed by the buyer.

The buyer's lien on goods also has the capacity to mislead. A potential secured financer may see that a retail merchant has a substantial stock of inventory and, after properly checking for prior encumbrances, he may advance credit on the faith of a security interest he has acquired in that stock. It is arguably unfair that his rights should be subject to a "hidden lien" which he had no means of discovering and which may substantially impair the value of his security. The argument would conclude that the creation of lien rights which will prevail over general creditors represents a substantial measure of reform. To go further, however, and interfere with vested property rights so as to dilute the priority position of a secured party is unwarranted.

The arguments outlined above are substantially the same as those set out in the Working Paper. Our tentative conclusion was described in the Working Paper in the following terms:

> This issue has given us some difficulty, but on the whole we do not see the buyer's lien over goods as a significant intrusion on the rights of secured creditors. They will usually be few in number and for small amounts when compared with the totality of the property to which the secured art may look. We think that the occasional loss of priority a uyer would quickly come to be regarded simply as a cost of doing business to be spread in the usual fashion.
>
> The issue as to the priority of the lien on goods has an analogue with respect to the lien insofar as it at aches to the account, and similar conclusions apply. In asserting his lien on the account, the buyer may find himself in competition with a secured creditor. Normally, security in an intangible is taken in the form of an assignment. Businesses will frequently make assignments of their accounts receivable to secured lenders and the terms of those assignments are frequently wide enough to catch a deposit account. For the reasons discussed in connection with the lien on goods, we believe the buyer should have priority.

Our tentative conclusion in this regard did not appear to concern the majority of our correspondents but, not surprisingly, it did provoke a vigorous response from the secured lenders who responded.

The general tenor of these responses was to repeat the arguments set out in the Working Paper to justify priority for the secured lender. It was also suggested that the buyer's lien could lead commercial lenders to re-examine their credit granting policies and the result may be that certain types of small businesses might find it difficult or impossible to qualify for loans.

A number of observations may be made on the latter suggestion. First, it is not a new one. The post-war era has seen significant activity by legislators and law reformers aimed at adjusting the legal balance between debtors and creditors. Some measures involve strengthening creditor's rights while others contemplate some erosion of those rights. When proposals in the latter vein appear they often raise concerns that significant limitations will be imposed on the availability of credit. Experience demonstrates that these concerns tend to be overstated.

It is against this background that we must confront similar concerns raised with respect to the buyer's lien. Obviously, one can envisage a measure that would be so oppressive to credit grantors that they would alter their lending practices as predicted. In our view, the buyer's lien is not such a measure. In the larger context of inventory financing we believe the amounts involved are trivial and, as we stated in the Working Paper, "would quickly come to be regarded...as a cost of doing business to be spread in the usual fashion."

Even if the buyer's lien did not result in any general restrictions on the availability of credit, there remains the question whether particular businesses might find it difficult to obtain financing. This presupposes a retailer that can obtain financing only by conducting business in a way which results in large amounts of money being prepaid by buyers who would stand no chance of recovering it if the retailer should fail. It seems clear to us that this constitutes a significant threat to consumers and that the public interest may be better served if such a retailer never opens its doors for want of financing. The restriction of credit to that kind of operation is not a prospect we find disturbing.

Finally, one must not lose sight of the fact that, at least as far as the lien on goods is concerned, the security interest of the lender is vulnerable to the rights of a *bona fide* purchaser of the goods where there has been an appropriation. The lender's security, so far as those goods are concerned, is precarious in any event.

The tentative conclusion reached in the Working Paper, and the proposal made, retain their force as the present view of the Commission. A buyer's lien should have priority over any consensual security interest in the goods or the account that are subject to the lien.

The conclusion set out above is confined to security interests created by agreement between the seller and his financer. There are, however, many other types of security interests which might arise by operation of law rather than by agreement between the parties. This led one correspondent to observe:

In an earlier report the Commission addressed the problems which arise from the existing multiplicity of unregistered liens many of which purport to rank ahead of each other and all other claims. Much time and money is now wasted in determining priorities. The addition of one more lien with priority is a retrograde step. Even though the buyer's lien is to have priority over consensual security interests there will be ample opportunity for argument with respectto priorities in relation to non-consensual charges including wages, landlord's rights of distress, sales tax and other impositions.

The concern raised is not one for which we have a ready answer. It might be possible to attempt to define a priority for the buyer's lien in relation to other non-consensual security interests, but it is not clear that much would be achieved by that. Probably the only legislated priority that would be assured of recognition would be a priority specified as subordinate to any other interest arising by operation of law. We do not think such a priority is appropriate. The buyer's lien should at least have the opportunity to compete for priority with other statutory claims.

This leads, however, to no resolution of the issue. It simply dumps it in the lap of the courts to sort out as best they can. This is a result with which we are distinctly uncomfortable. Complaints are legion about the difficulties created by competing statutory liens and the emergence of yet another would not be welcome.

The solution, for the most part, lies outside the scope of this Report. In an earlier Report, the one referred to by our correspondent, we examined a variety of liens which arise in favour of the Provincial Crown and its emanations. We recommended that most of those statutory liens be abolished. Those that remained (ones that could be justified on some principled basis) should be rationalized and brought within a well defined priority structure. If these recommendations were implemented, and the process were duplicated with respect to federal legislation, we would then have the starting point for the devdopment of a rational priority structure encompassing all remaining statutory liens, which could include the buyer's lien. Until the day comes that such a rationalization is possible, the best one can do in the context of the buyer's lien is to recognize that a problem exists, agonize over it, and leave it to the courts hoping the problem will not arise too often.

Potential competition with one other class of person having a consensual interest in goods must also be considered. That person is the *bona fide* purchaser of goods which may be subject to the buyer's lien. This person could be another retail purchaser such as the "second buyer" referred to in the example in the previous chapter. He might also be a buyer in bulk of the seller's inventory such as a purchaser of the business itself. What, if any, rights should the holder of a buyer's lien enjoy against persons in this position?

So far as the "second buyer" is concerned, the answer is fairly clear. The "second buyer" would be protected from most other kinds of interests by the present law and we believe that should continue with respect to the buyer's lien. The appropriation of goods to a specific retail sale should, therefore, discharge any buyer's lien which may have existed against them. The lien would, of course, continue against the account.

The willingness of the law to protect the "second buyer" in the retail sale situation simply reflects commercial convenience and the desirability of protecting transactions which take place in the ordinary course of the seller's business. A bulk transfer of inventory, however, is almost always outside the usual course of the seller's business and the position of the bulk purchaser raises a more difficult question.

In the Working Paper, our provisional conclusion on the position of the bulk transferee was described in the following terms:

> On the whole, we believe this class of purchaser should also be protected. Because there is no registration requirement, or similar mechanism which would render buyer's liens easily discoverable, these purchasers are vulnerable. We think that fairness dictates that a lien should not survive a transfer of this kind either.

A majority of our correspondents appear to agree with that conclusion.

We adhere to the proposal made in the Working Paper. Goods that are subject to a buyer's lien may be appropriated to a different sale and when that occurs the lien ceases to attach to those goods. This would be true whether or not the sale is in the usual course of the seller's business, so long as the sale is *bona fide.*

One type of competing interest not yet considered is that of another buyer who claims a lien similar to that of our hypothetical original buyer. At this point it is helpful to recast slightly our previous example:

Buyer number 1, as in the previous example, purchased a refrigerator of a particular model. The seller has 12 such refrigerators in stock but none was appropriated to the sale before the seller's insolvency intervened. There are 19 other purchasers of similar refrigerators in a similar position (buyers 2 to 20).

Under the structure of rights described so far the position of the parties would seem to be this: buyers 1 to 20 all have a lien on the 12 refrigerators and on the deposit account into which the seller normally pays the proceeds of his retail sales.

A potential difficulty is that, in the absence of specific guidance, the order of priority in a competition between buyer's liens might be held to be determined by the order in which the liens were created. On this view, as between sellers number 1 to 20, those who purchased first would have priority and those who purchased last might realize nothing on their liens. We do not believe this provides a fair resolution of the claims. When a pool of assets must be liquidated to satisfy buyers liens, and the fund created is insufficient to satisfy them all, the buyers should share in the fund ratably. This is the solution proposed in the Working Paper and no one disagreed with it.

CHAPTER VII

From the consumer's view, to have a lien over goods or a deposit account, and having the goods in his home or the repayment back in his pocket may be two quite different things. Our hypothetical consumer might regard the way in which the first circumstance is to be translated into the second to be a matter of high importance. How is this gap to be bridged? What procedures or techniques will result in the buyer's inchoate rights being transformed into a tangible asset? Who is responsible for invoking these procedures? How are the costs of these procedures to be distributed?

In the Working Paper, these issues were addressed only obliquely, or not at all. This led to expressions of concern from some of our correspondents. Interestingly, these concerns appeared to come from quite different view points. One view saw the procedural burden on the consumer:

> A greater reservation I have about the creation of a consumer buyers' lien is that I doubt that the remedy would be utilized that frequently. The problem I see is that a buyer's lien frequently could not be enforced without resorting to litigation. Litigation would tend to arise because determining entitlement to a lien often would involve difficult factual issues. Further, in most situations the seller would owe money to a secured creditor who would have the financial resources to contest the claims that consumer buyers may have to liens. When faced with the prospect of litigation most consumers would forego their claim. This is because they either would not have the means to rely on lawyers or would not have the inclination to do so because the amount involved was so small.

A spokesman for secured lenders saw the procedural issue in terms of the burden it would impose on those attempting, in good faith, to deal with buyer's liens:

> We question whether the proposals would be workable, especially in situations where there is no formal proceeding such as liquidation, winding up, bank ruptcy or receivership. Where there is a formal proceedin g the proposals would cause delay and increase costs. Those charged with responsibility for orderly liquidation of assets and distribution amongst claimants wi 1 become enmeshed in adjusting consumer complaints which may relate to small amounts but could be numerous. Savings institutions are not equipped to mediate disputes between buyers and sellers of merchandise. Receivers, trustees and liquidators would be forced to spend time adjusting claims stimulated by legislation implementing the proposal.

Both of these correspondents have outlined what might be regarded as "worst case" fact patterns. We do not see them as representative of the majority of cases in which one or more buyer's liens are likely to be asserted. We believe it is important, therefore, to set out our perception of the way in which the buyer's lien will operate in practice.

It would be naive to think that one could profile a “typical” fact pattern in which a buyer’s lien is likely to arise, with reference to the probability of the seller’s insolvency. *De facto* insolvencies can occur in any part of the retailing sector and we are not in a position to identify any particular kind of retail undertaking as being inherently more prone to insolvency than any other.

Nonetheless, certain types of businesses, owing to the lines of merchandise they carry and the general way in which their business is conducted, may be expected to give rise to fewer liens than others. In many businesses prepayment by the buyer is unusual. In a “cash and carry” type of operation goods are almost always appropriated to the sale at the time the buyer makes his payment so there is no opportunity for a lien to arise.

What are the characteristics of a “cash but no carry” transaction? One possibility is that the goods have not yet been manufactured or must be the subject of a special order by the seller and in either case a deposit from the buyer is called for.

A second possibility might be that the buyer and seller are not dealing face to face and a transfer of physical possession at the time payment is made is not possible. This might occur, for example, if the seller deals on a mail order basis or one of its more modern manifestations involving a telephone order accompanied by an authorization to document payments through a charge card.

The final kind of “cash but no carry” situation will give rise to a large proportion of liens on goods and will come closest to being a transaction which might be labelled “typical.” A first characteristic of the transaction is that the goods will be of a type or kind which are too large or bulky to be conveniently transported by the consumer in person. It will be necessary to rely on a delivery service provided by the seller. A second characteristic is that the goods are sufficiently non-individualistic that there would be no appropriation at the time the sale is made. The buyer will be satisfied if any one of a number of similar items are ultimately appropriated to the sale.

What kinds of goods conform to these characteristics? Large appliances and certain types of furniture. It is no accident that in the preceding chapters we adopted the paradigm of the refrigerator as an item of consumer goods over which a lien might be asserted.

Mentioned earlier were transactions in which the buyer is expected to put up a deposit. This may include items being manufactured to the buyer’s specifications such as a picture frame or a made-to-measure suit. A deposit may also be required where the seller must acquire the goods on special order.

In the “deposit” situations the most important aspect of the lien will be its attachment to the seller s bank account. This is because once special-order goods have been received by the seller or specially manufactured goods have been finished, they are almost immediately appropriated to the sale and the buyer is protected by that appropriation. Where the protection of the lien is needed is where the deposit has been paid, but no goods have ever come into being or come into the possession of the seller cap able of being appropriated to the sale. This is why we say the account aspect of the lien is of most importance here. If the buyer obtains any relief it is only because there is money in the account to which the lien can attach.

What conclusions, if any, might be drawn from this analysis? The first is that the kinds of situations in which the buyer’s lien over goods acquires real significance is likely to be limited to a small number of familiar sorts of retailing operations. The number of liens on goods existing at any given time with respect to a particular seller will obviously depend on that seller’s overall business volume. Their total numbers, however, should not be inordinately large when compared to the totality of the seller’s inventory.

There will be somewhat more scope for the account aspect of the lien to arise, if only because of the much larger time that might elapse between payment and appropriation in the kinds of examples described above. The trade-off is that the lien against the account presents fewer practical and conceptual difficulties, than the lien over goods.

In summary, we do not see most cases in which a buyer’s lien might be asserted as giving rise to administrative questions of extraordinary difficulty or complexity. We believe that an enforcement regime and philosophy tailored to this reality should be our goal. If ninety percent of the claims can be dealt with in the framework of a simply conceived enforcement philosophy we will have achieved virtually everything we set out to do. What, if anything, should be done to meet the needs of the exceptional cases is a matter for separate consideration.

Occasionally, a businessman will simply close his doors and walk away from his business and his debts, but more often the final stages of a business failure are accompanied by some sort of final blow which puts it under. This blow frequently takes the form of one or more creditors taking steps to salvage what they can from the business assets. Some of the steps they might take are the remedies which were described in Chapter II: bankruptcy, receivership and execution proceedings.

Almost always, therefore, there is a person in *de facto* control of the seller’s assets who is in a position to deal with them to see that buyer’s lien claims are satisfied.

Where that person is a trustee in bankruptcy, a sheriff, or a court-a p pointed receiver, that person is under a special duty to deal with claims on property in his possession or control fairly and in accordance with the law. We have no reason to believe that receivers that are appointed privately (under an instrument rather than by court order) consider themselves any less bound to observe high standards of conduct. It is not in the interests of any professional trustee to acquire a reputation for needlessly obstructing claims or engaging in sharp practice in his administration.

We believe that professional trustees are anxious to observe the law, if they are told clearly what the law is. It follows from this view of the process that we believe a simple statement, in legislation, concerning the rights of buyers and the existence and characteristics of the buyer's lien should be sufficient in most cases where the sheriff or a professional trustee is involved to see that the consumer buyer is treated fairly and his rights observed.

Clearly, the reliance on professional trustees to administer buyer's liens may place some burdens on them which do not presently exist. Our scheme does not contemplate any reward or remuneration for this activity, thus any additional costs must be borne and distributed like any other cost of doing business. It is important that the magnitude of this additional burden not be overstated.

The reality is that a professional trustee is frequently embroiled in sorting out a multitude of claims to goods which may come under his control. For example, a retailer might operate a lay-away plan with a broad customer base. In most such cases goods will have been appropriated to a particular contract of sale so the buyer's rights will have vested and the trustee or receiver may, in fact, have to devote substantial time and expertise to winding up the lay-away scheme.

Examples like this could be multiplied. When they do arise they are dealt with without fuss and, one hopes, without any costs being charged back to the buyer. We would expect buyers lien claims to be dealt with in the same spirit.

The position of the professional trustee also calls for consideration from a slightly different perspective. In the previous chapter we referred to the fact that the recommended buyer's lien would be undiscoverable by a person who subsequently acquired an interest in goods subject to it. For this reason it was recommended that a subsequent purchaser of goods should take free of the buyer's lien.

The professional trustee appointed to assume control and liquidate the seller's property for the benefit of creditors is equally vulnerable. He will be anxious to get on with his task but the possibility of outstanding buyer's liens may act as a deterrent. If the trustee deals with property that is subject to a buyer's lien, to the detriment of a lien claimant, the trustee might be liable in an action for damages for conversion. In the Working Paper, we asked how the competing interests of the trustee and the buyer might be balanced:

A number of approaches to this issue may be possible, but our tentative preference is simply to insulate the receiver or trustee from liability where he has acted *bona fide* and without knowledge of the buyer's lien. Essentially this would p lace an onus on the buyer to bring his lien to the receiver's attention as soon as he can. If he sleeps on his rights, he may suffer for it. The receiver would be able to proceed with an orderly realization of the seller's propert having regard only to the claims of those buyers of which he has knowledge.

In the responses to the Working Paper concerns were expressed that this proposal impaired the integrity of the buyer's lien scheme. One response observed:

Proposal No. 6 may be too simple. When an insolvency occurs a trustee is often in place before buyers know it. A trustee may dispose of stock quickly and with impunity in a *bona fide* manner. The only way a trustee would be able to ascertain that a buyer had an interest would be from the seller's books. Bankruptcies often entail poor or non-existent record keeping. Perhaps receivers should be required to post a notice on the business premises of the seller, and a time limit should be imposed with respect to the disposition of the seller's goods to third parties. If no disposals may be made for 14 or 30 days, purchasers, who had paid their moneys and had not received delivery of the goods, would have an opportunity of protecting themselves by giving the trustee notice of their claim.

Other responses saw a danger in the combined effect of that proposal and the earlier one respecting the effect of a sale of goods subject to a lien:

One problem that may be created by the desire for simplicity concerns proposal 4, which in essence makes the Buyer s Lien on goods unenforceable if the goods have been bona *fide* sold. The trustee/receiver may come under pressure from creditors who have a security interest in goods to sell the goods quickly before any Buyer's Liens can be discovered. The proposal creates no duty on the part of the trustee/receiver to attempt to discover if any Buyer's Liens exist or to allow any amount of time for buyers to notify of their liens. The Commission might wish to consider the desirability of such measures.

The comment stimulated by this proposal has led to its very careful reconsideration. While sympathetic to the concerns that have been raised, we remain of the view that the approach taken in the Working Paper is the correct one. The professional trustee faces a difficult task as it is and our basic recommendations with respect to the buyer's lien will add a new dimension of complexity. We believe that fairness demands that the scheme give some recognition to the interests of the trustee and the realities of the realization process. To stipulate a time before which no disposition of the seller's goods could be made to a third party would unnecessarily and dangerously limit the flexibility of the trustee/receiver. The exigencies of the situation may require immediate action. The trustee may, for example, be a receiver/manager whose specific mandate is to keep the retailer's business operating as a going concern. This means that the doors must be open for business with all goods exposed for sale immediately.

We expect buyer's liens to be asserted in only a minority of cases. To fetter the trustee in all cases, either through directly imposed time limits or simply by leaving the question at large so the trustee receiver proceeds at his peril, has a flavour of overkill. The tentative conclusion reached in the Working Paper on this issue retains its force as the view of the Commission.

Earlier in this chapter we observed that in all but the most unusual cases the administration of assets subject to a buyer's lien, for the benefit of the claimants, should normally rest with a professional trustee. The resulting burden will not, in the vast majority of cases, be onerous. There are, however, two kinds of exceptional circumstances in which these expectations may not be met. The first will be a situation where, owing to disinterest on the part of the seller's creditors or the particular way in which the seller's financial affairs have evolved, there is no professional trustee who has stepped in to deal with the seller's assets on an insolvency. This raises a question about the extent to which our scheme should provide machinery which would enable the buyer to take positive steps to bring the assets subject to the lien under the control of someone who was prepared to deal with them on his behalf.

We think that a failure to provide such a mechanism would constitute a hiatus in the buyer's lien scheme. The *Small Claim Act* contemplates the enforcement of certain small liens in Provincial Court. It provides:

> 2. (1) The court, among other powers, has jurisdiction in
>
> (b) actions or enforcing a ... lien over chattels where the amount secured does not exceed the sum of $3,000.

This jurisdiction would accommodate the vast majority of buyer's liens, We believe an enforcement action in Provincial Court (or a court having the appropriate monetary jurisdiction if the prepayment exceeds $3,000) is an appropriate vehicle for the assertion of the buyer's rights where there is no trustee to assist him.

The Provincial Court jurisdiction cited above is restricted to a "lien over chattels" and, thus, does not extend to the lien over the account. Should the buyer have a special remedy to enforce his lien over the deposit account? It might be possible, for example, to develop a remedy akin to a demand notice to be issued at the behest of the buyer and which would bind funds in the hands of a deposit institution. One of our correspondents saw considerable danger in any mechanism which permitted the buyer, personally, to make a demand on a deposit institution:

> [Clan he [the buyer] attend at the saving institution where the seller deals and demand a portion of the credit, if any, in the seller's account? If so, how is the institution to know whether the claim is valid or whether there are other lien claimants who are entitled to have the balance in that account apportioned? Can he assert a lien against the seller's account if the payment is made with respect togoods which the seller does not otherwise deal in? if so, how can the seller's bank assess the validity of the claim?
>
> We believe that there would be a devastating effect on the reputation and credit of a merchant if buyers are armed with a weapon which they can use to upset the merchant's relations with his banker and suppliers and attract unfavourable publicity by merely alleging non-delivery.

While we believe the consequences which are suggested by this correspondent are somewhat overstated, on the whole we believe that direct enforcement rights against the deposit institution would add little to the buyer's arsenal. Only rarely, in the kind of situation where direct enforcement would be necessary, would there be anything left in the account. In most insolvencies the bank account is the first asset to go. In any event the buyer can always commence an ordinary action to recover his deposit an d garnishee the account. We would therefore make no provision for the enforcement of a buyer's lien against a deposit account except through a professional trustee.

CHAPTER VIII

The translation of our recommendations into legislation raises several threshold issues. Should implementing legislation take the form of a separate statute or should a buyer's lien scheme be grafted onto an existing statute by an appropriate amendment? The latter approach seems preferable. While developing the buyer's lien scheme as a discrete statute presents no theoretical problem, the legislative processes leading to implementation seem, in practice, to function more readily and more smoothly when changes in the law can be dealt with through amendment rather than wholly new legislation.

What Act might provide an appropriate vehicle for a buyer's lien scheme? This question was raised by one of our correspondents:

> Since the Buyer's Lien is "consumer" legislation, it could be incorporated into the existing *Consumer Protection Act,* perhaps as a separate Part. Some of the definitions and the application of the *Consumer Protection Act* (to goods not for resale or business use) might be helpful including the Buyer's Lien provisions. Alternatively, the *Sale of Goods Act* might be an appropriate location for the Buyer's Lien provisions.

Our conclusion is that the *Sale of Goods Act* provides the most hospitable environment for buyer's lien provisions. The scheme shares a number of basic concepts with the *Sale of Goods Act* and the drafting can embody without reservation or explanation the specialized vocabulary used in the Act.

Our draft legislation, therefore, takes the form of a new "Part" of the *Sale of Goods Act.* The Act, in its present form, consists of 72 sections and is divided into eight Parts. Our addition, therefore, will form Part 9 of the Act and commence with section number 73.

Following the draft legislation, in Chapter IX, will be a brief comment on it from a constitutional perspective.

SALE OF GOODS AMENDMENT ACT, 1987

HER MAJESTY, by and with the advice and consent of the Legislative Assembly of the Province of British Columbia, enacts as follows:

1. The *Sale of Goods Act,* R.S.B.C. 1979, c. 370, is amended by adding the following Part:

Part 9

This will become part 9 of the *Sale of Goods Act* and will follow the provisions of the Act in its current form.

BUYER'S LIEN

Interpretation

73. In this Part

"Buyer's lien" means a lien arising under section 74;

The term "buyer's lien" is a core concept of this Part and is used throughout.

A lien arises under section 74 when the buyer has paid for unascertained or future goods.

"Payment includes an obligation incurred by the buyer to a person, other than the seller, to whom the buyers remains liable notwithstanding a default by the seller;

The expansive definition of "payment" is intended to sweep in a payment made by way of a third party credit card.

This means that the buyer who makes an advance payment by means of a charge card will be entitled to a buyer's lien to the same extend as if he had prepaid in cash or by cheque.

Section 28(4) of the *Interpretation Act* provides that related terms such as "pay"and "paid" will have a corresponding meaning.

"seller" includes

This definition is to make it clear that a number of provisions of Part 9 which apply to the seller also apply to the trustee.

(a) a successor in interest or title of a seller, and

(b) a trustee;

"Trustee" is a defined term.

For example, the trustee can do the tings the seller might have done under section 75(1) to discharge a buyer's lien.

The trustee could exercise the option given the seller under section 75(2).

"trustee" means a person who assumes control of a seller's property by operation of law, under legal process or under the terms of a security agreement and includes a sheriff, a trustee in bankruptcy, a liquidator and a receiver

The term "trustee" is used throughout Part 9 as a compendious term to describe the seller's successor in interest who will assume control of the seller's property to deal with it for the benefit of a particular creditor or of creditors generally.

Buyer's lien

74. Where in the usual course of a seller's business the seller makes an agreement to sell goods and

Section 74 is the central provision of Part 9. It creates the lien and describes the property to which it attaches.

(a) the buyer pays all or part of the price,

(b) the goods are unascertained or future goods, and

(c) the buyer is acquiring the goods primarily for his personal, family or household use,

The requirement that the sale be made in the usual course of the seller's business means a lien cannot arise in a "private" transaction.

Paragraph (c) confines the lien to "consumer goods" as that concept is used in modern personal property security legislation.

then the buyer has a lien on

(d) all goods

(i) which are in, or come into, the possession of the seller and are held by him for sale,

(ii) which correspond with the description of or with any sample of the goods under the agreement to sell, and

(iii) the property in which has not passed to a different buyer under a different contract of sale, and

Note that it is the buyer's use that determines whether or not goods are to be characterized as consumer goods. Thus, no lien would arise where a builder makes a prepayment in respect of an appliance intended for installation and resale.

The drafting of paragraph (d) is such that the lien attaches to all goods held for sale that might be appropriated to the contract. It is not necessary that the seller have title to those goods.

(e) any account in a savings institution in which the seller usually deposits the proceeds of sales.

"Savings institution" is defined in the *Interpretation Act* as follows:

"Savings institution" means a bank, credit union, or a trust company registered under the *Trust Company Act*.

Termination of lien

75. (1) A buyer's lien is discharged when the seller

This subsection sets out two of the ways in which a buyer's lien may be discharged

(a) fulfills the contract of sale by causing property in goods to pass to the buyer in accordance with the contract of sale; or

(b) refunds to the buyer all money paid in respect of the purchase price of goods.

Whether the lien is to be discharged through an appropriation of goods or through a refund of the prepayment is for the seller to decide (subsection 2).

"Seller" is defined to include "trustee."

(2) Whether a buyer's lien is to be discharged under subsection (1)(a) or subsection (1)(b) is at the option of the seller, but a discharge of the lien under subsection (1)(b) does not affect any right of action the buyer may have for a breach of the contract of sale.

This gives the seller the right to decide the way in which a buyer's lien will be discharged

The discharge of the lien does not mean the buyer's rights are exhausted. He may still wish to maintain an action for breach of contract if he lost a bargain through the failure to complete the transaction. Subsection (2) preserves this right of action.

(3) A buyer's lien ceases to bind goods that are appropriated to a sale made in god faith to a different buyer, whether or not that sale is in the usual course of the seller's business.

This subsection implements the policy that the appropriation of goods which are subject to a buyer's lien to a different sale discharges them of the lien.

This feature will be necessary to the integrity of the scheme in the day-to-day operation of most businesses when the lien is dormant.

The protection of sales outside the usual course of the seller's business is aimed at the bulk transfer which may involve a sale of the whole of the seller's inventory, possibly as part of the sale of the business itself.

This feature of the draft reflects a policy decision discussed in the test of the Report.

Priority

76. A buyer's lien has priority over any interest taken or reserved in property referred to in section 74, under a mortgage, conditional sale, consignment, assignment or other transaction made to secure payment or performance of an obligation of the seller.

This provision specifies a high priority for the buyer's lien. A discussion of the reason for this priority is set out in Chapter VI D.

If, at the time implementing legislation is enacted, personal property security legislation is in place the drafting of this provision can be simplified through reference to a "security interest" as defined in that legislation.

Trustee's duty

77. (1) A trustee who assumes control of a seller's property is, with respect to any valid and subsisting buyer's lien of which the trustee has knowledge, under a duty to ensure that property subject to the line is dealt with for the benefit of the buyer in accordance with this Part.

This section makes it clear that there is a duty on a trustee to see that the rights of buyers arising under Part 9 are observed, to the extend that he has knowledge of them.

(2) A trustee who deals with property that is subject to a buyer's lien is not liable to the buyer if the trustee acts in good faith and without knowledge of the lien.

This provision is a counterpart to subsection (1). It protects the trustee who deals with property subject to a lien of which he has no knowledge so long as he acts *bona fide*.

What constitutes *bona fide* in this context will depend on the circumstances of the case.

Proceedings

78. (1) Subject to subsection (4), a person entitled to a buyer's lien on goods may commence a proceeding to enforce the lien.

The purpose of section 78 is to create enforcement machinery for the assertion of the buyer's rights against goods where there is no trustee.

This subsection provides for an action to enforce the lien.

The court in which the action may be brought is specified in subsection (2).

The right to bring an enforcement action is subject to subsection (4) which requires that the goods not be in the custody of a trustee.

(2) A proceeding under subsection (1) may be brought

A discussion of court jurisdiction is found in the text at Chapter VII D.

(a) in Provincial Court where the amount of the prepayment does not exceed $3,000,

(b) in a County Court where the amount of the prepayment does not exceed the monetary jurisdiction of that Court, or

(c) in the Supreme Court.

(3) In a proceeding to enforce the lien the court may make one or more of the following orders:

This provision describes the kinds o ordrs the court may make on an enforcement action.

(a) an order declaring that a buyer's lien exists;

(b) an order that goods be seized and sold, and the proceeds applied to the discharge of one or more buyer's liens;

(c) an order that goods be seized and delivered to the holder of a buyer's lien to discharge the lien.

(4) No proceeding may be brought under this section to enforce a buyer's lien against goods that are in the possession, custody or control of a trustee.

This provision limits the use of the enforcement action to situations where there is no trustee to deal with the goods for the benefit of the buyer under section 77(1).

Several liens

79. (1) Where there are 2 or more buyer's liens over the same property and

This provision calls for *pro rata* distribution of the proceeds realized on the enforcement of two or more buyer's liens where the proceeds are not sufficient to satisfy all claims.

(a) the seller fails, or is unable, to discharge the liens, and

(b) on the enforcement of the liens insufficient money is realized to satisfy the claims of those buyers,

then, subject to subsection (2), the shortfall shall be attributed to their claims in the proportions that their respective claims bear to the sum of those claims.

(2) The equitable principles respecting the marshalling of claims applies to competing buyers' liens.

The equitable principles respecting marshalling apply when two creditors claim the same property to satisfy an obligation but one of those creditors also has other property to which he can look.

The principles of marschalling compel the second creditor to look first to the property to which he has exclusive rights and only then to the property to which he has shared rights.

In the context of buyer's liens, buyers A and B might have prepaid for two different items or merchandise. The seller's inventory, however, might consist of merchandise capable of being appropriated only to the sale to A.

In this example A could therefore look to both the item in the seller's inventory and the account to satisfy his lien. B would have rights against the account only.

The principles of marshalling would require that A exhaust his remedies against the inventory before proceeding against the account.

Application

80. (1) The provisions of htis Part and the regulations made under it apply notwithstanding any waiver or agreement to the contrary.

No waiver is permitted.

(2) Nothing in this Part derogates from the rights of a buyer under a contract of sale including the right of a buyer to

This preserves the buyer's rights in relation to other aspects of sales law.

(a) reject goods where he would otherwise be entitled to do so, or

(b) claim damages in respect of defective or deficient goods.

CHAPTER IX

In this Report, the strategy for reform adopted is to create property rights in favour of the buyer who prepays for consumer goods. The recognition or enforcement of these rights is intended to provide relief if the seller defaults. Some of the considerations which prompted the adoption of this strategy were set out in Chapter IV.

The Working Paper did not discuss, at length, the constitutional implications of this strategy or of particular proposals. It went no further than pointing to the right of the Province to legislate with respect to property and civil rights as a basis for action. Some of our correspondents were uneasy and raised concerns about the ability of the Province to legislate effectively along the lines proposed in the Working Paper. Reservations were expressed respecting the scheme generally, and with respect to particular aspects of it.

The general reservation was that legislation implementing a buyer's lien scheme might be "colourable" and characterized by the courts as legislation respecting insolvency. If that occurred, it might be struck down totally as *ultra vires* the Province. A second concern was that even if the scheme was effective with respect to a *de facto* insolvency dealt with outside the *Bankruptcy Act (e.g.* a receivership), the scheme might be held *ultra vires* to the extent that a buyer's lien could not be raised against a trustee in bankruptcy. A third concern was that the exceptional priority our recommendations would accord a buyer's lien might not be recognized in a competition with a security interest regulated by federal law. In particular, it might not prevail over security created under section 178 of the *Bank Act.*

The purpose of this chapter is to offer some brief observations on these concerns.

The scope of the federal power respecting bankruptcy and insolvency is a recurring issue which tends to surface frequently when changes in debtor/creditor law are discussed at the provincial level. The question is usually framed as one of how far a province can go in enacting legislation which may incidentally affect rights in a bankruptcy or which somehow turn on the insolvency of a person. The question arose most recently in the context of our own work in connection with the constitutionality of the *Fraudulent Preference Act.* We pointed to the decision of the Supreme Court of Canada in *Robinson* v. *Countrywide Factors Ltd.* as evidence of how far the courts are prepared to go in upholding provincial legislation which on the face of it appears to intrude into federal jurisdiction.

Our understanding of the consitutional position follows. Legislation may have both a provincial and federal aspect. Legislation is valid from a provincial aspect if it is of general application and is, as a matter of "pith and substance," legislation respecting property and civil rights in the province rather than bankruptcy and insolvency. Its validity is not affected by the fact that it may, incidentally, modify the rights of persons in a bankruptcy.

In considering the constitutional validity of the buyer's lien scheme a number of factors should be borne in mind. The first is that nowhere in the draft legislation does insolvency appear as a key concept. What triggers the creation of the lien is a prepayment by the buyer and what will discharge the lien is an appropriation of goods to the sale, or a refund of the prepayment. It will be seen from this that a very large number of transactions will actually give birth to buyer's liens, but those same liens will very quickly vanish as goods are appropriated or delivered. In a majority of transactions in which a buyer's lien arises the seller's solvency is unquestioned. The insolvency of a party is not, therefore, a condition precedent for rights under our recommendations to arise.

This might be contrasted with the *Fraudulent Preference Act* under which a condition precedent to rights or relief is that a person be "in insolvent circumstances" or "on the eve of insolvency." As we pointed out above, the Supreme Court of Canada has held such legislation to be a valid exercise of provincial power.

Nor does the enforcement of the lien, by or on behalf of the buyer, turn on the seller's insolvency. Here, the key is a default by the seller--a failure to do either of the things which would result in a discharge of the lien. This default may, and usually will, reflect an insolvency on the part of the seller, but that need not always be the case. It is possible to envisage situations in which the buyer may, quite properly, wish to enforce the lien because there has been a default by a solvent seller.

It must be conceded, however, that the main purpose in creating the remedy of the buyer's lien is to improve the position of the buyer on the seller's insolvency and, in most cases, the buyer's lien rights have no practical significance until an insolvency occurs. Does that fatally taint legislation providing for a buyer's lien? If it does, then a whole range of other provincial legislation is also called into question. Provincial legislation gives or regulates liens in favour of particular persons or groups where it appears that the public interest requires it. The rights given to builders, repairers, warehousemen, and threshers are only a few examples. If legislation which provides for a buyer's lien is under a constitutional cloud, it strikes us that these other lien rights are also endangered. Similar observations might also be made respecting provincial laws that govern consensual security interests such as mortgages of land or interests in personal property. The constitutionality of such lien and security provisions has never, so far as we are aware, been doubted.

It must also be remembered that the principal way in which the federal jurisdiction over insolvency is manifested is through the *Bankruptcy Act.* But the *Bankruptcy Act* is not invoked in every insolvency. In many cases the administration of a bankrupt's property takes the form of a receivership and is almost wholly governed by provincial law. All of the factors outlined above suggest to us that a buyer's lien scheme, along the lines described in the previous chapter, would survive a constitutional challenge aimed at its basic characterization.

One correspondent, while not questioning the constitutionality of a buyer's lien scheme in the broad sense, did raise a concern whether the lien would prevail against a trustee if the *Bankruptcy Act* has been invoked formally. On this question, we can see no reason why the courts should treat the buyer's lien any less generously or accord it any less validity in a bankruptcy than other liens which arise in a private law context.

There have been instances where the courts have refused to recognize liens created under provincial statutes in a bankruptcy context. Those instances, however, almost all involved a lien legislated by a provincial government, in favour of itself or one of its emanations, to secure a tax-related claim. The *Bankruptcy Act* sets out clearly the priority that is to be accorded to tax claims and in that context a lien is easily characterized as a colourable device aimed at frustrating the clearly expressed will of Parliament. There is, in the *Bankruptcy Act,* no such clearly expressed will that might be invoked to override a buyer's lien.

Another specific concern raised related to our proposal that the buyer's lien have priority over any consensual security interest. The focus of the concern was a competition between the buyer's lien and security arising under section 178 of the *Bank Act.* That Act provides a unique form of security to chartered banks. The effect of taking security under the *Bank Act* is to give the lender "the same rights and powers as if the bank had acquired a warehouse receipt or bill of lading in which such property [subject to the security] was described." In taking this approach the *Bank Act* has cast the secured party's rights in a conceptual mold quite different from that of other legislation which provides for or regulates the taking of security. The result is there has been much complexity and uncertainty respecting the relationship of *Bank Act* security to that arising under a range of provincial laws. Calls for reform are frequent and impassioned.

In the context of liens the most recent attempt to state a general rule respecting priority is by Bradley Crawford in Crawford and Falconbridge on *Banking and Bills of Exchange.* He first notes that:

> ...bank security may come into conflict with.., lien claims based on provincial legislation or case law establishing a privilege or property interest in favour of persons such as repairers, woodmen, drovers and the like.

Later he states:

> Competition may also arise between the bank security and liens in favour of particular creditors under competent provincial legislation. Since the Supreme Court determined that such liens do not trench upon the paramount rights under the federal legislation the issue has become a simple one of priority. If the rights of the lienor have arisen before the bank takes its security or arise routinely in the processing of inventory in the ordinary course such that the bank must be deemed to have consented to them then they rank in priority to the bank security.

While one cannot pretend the priority position is clear it is at least arguable that the buyer's lien we recommend is one which arises out of a dealing with the inventory which is capable of giving rise to priority over the bank's interest.

We think it may fairly be observed that nothing can be stated with absolute certainty respecting the constitutional implications of the buyer's lien scheme we recommend. No promises can be made in uncharted constitutional waters such as these. The question, as we see it, is whether the danger of the whole of the scheme being rejected by the courts as *ultra vires* the Province is so great that the scheme is not worth pursuing.

On this issue, while the answer is not clear beyond doubt, we do have a high degree of confidence that the legislation would pass muster constitutionally. We do not believe that the possibility of the scheme being struck down totally is sufficiently real that the Province should feel inhibited about proceeding.

We also recognize a threat with respect to the specific concerns. We concede that it is possible that the courts might not accord the buyer's lien top priority when in competition with *Bank Act* security or, less likely, hold that the buyer's lien is not effective in a formal bankruptcy. We have indicated the lines of argument which might be raised in favour of the validity of the lien and its priority in these circumstances. These arguments might or might not prevail but we do believe they demonstrate that provincial rights here can be credibly asserted.

If the buyer's lien were held to be ineffective in either or both of the specific circumstances considered, that would be unfortunate but it would not be fatal to the integrity of the scheme. It would obviously be desirable that the lien should survive in a bankruptcy, but the fact that so many insolvencies are dealt with through a receivership which is governed by provincial law suggests that the interests of the prepaying buyer would still be significantly advanced by the lien scheme. Similarly, it would not be fatal if a buyer's lien had to bow before *Bank Act* security. It would merely mean that the lien would be somewhat less useful than it might otherwise be.

In summary, none of the constitutional concerns raised for consideration persuade us that the buyer's lien scheme should be abandoned or significantly altered. To proceed with legislation is not free of constitutional peril but we believe that the rewards, in terms of the creation of a new and needed consumer protection measure, far outweigh the risk involved that the legislation, or part of it, might ultimately be found to be *ultra vires.*

CHAPTER X

We believe that the plight of the buyer who has made a prepayment in respect of consumer goods, but has not acquired any rights in those goods, calls for attention. The present situation creates both the appearance and substance of unfairness and, we believe, fails to meet the reasonable expectations of consumers who engage in transactions such as those described above.

It is true that the measures which we recommend will involve some erosion of the rights of competing creditors, both secured and unsecured, but we do not believe they will cause any major upheaval in the overall patterns of commercial credit. Moreover, the lien on the account does only for the consumer what he would be capable of doing for himself to retain beneficial ownership of the purchase money if he were legally sophisticated. We think he can be forgiven a lack of expertise in sales law. This is an area in which the general law should do for the consumer what he is, in practice, unable to do for himself.

We also wish to emphasize that nothing in these recommendations should a ffect the conduct of business on a day-to-day basis. The buyer's lien would remain dormant and be irrelevant to the vast majority of sales transactions. These rights would normally acquire practical significance only on a default of the seller arising out of his *de facto* insolvency, when the buyer's interests are in competition with the seller's other creditors.

We wish to express our gratitude to all those who took the time to consider the Working Paper and responded to it. The comments we received were most helpful in sharpening our views and assisting our deliberations.

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