LAW REFORM COMMISSION OF BRITISH COLUMBIA

report on

DEBTOR-CREDITOR RELATIONSHIPS

(PROJECT No. 2)

1975

PART V—PERSONAL PROPERTY SECURITY

LRC 23

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

The Commissioners are:

LEON GETZ, *Chairman.*
RONALD C. BRAY.
PAUL D. K. FRASER.
PETER FRASER.
ALLEN A. ZYSBLAT.

Mr. Keith B. Farquhar is Director of Research to the Commission.
Mr. Arthur L. Close is Counsel to the Commission.
Mr. David Cohen is Legal Research Officer to the Commission.
Miss Patricia Thorpe is Secretary to the Commission.

The Commission offices are located on the 10th Floor, 1055 West Hastings Street, Vancouver, B .C.

TABLE OF CONTENTS

To THE HONOURABLE ALEX. B. MACDONALD,
Q.C., ATTORNEY-GENERAL FOR BRITISH COLUMBIA:

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

REPORT ON DEBTOR-CREDITOR RELATIONSHIPS
(Project No. 2)

Part V—Personal Property Security

This Report has been prepared in the Commission∗s study on debtor-creditor relationships, which is Project No. 2 in the Commission∗s Approved Program.

The present law of this Province which governs transactions secured by an interest in personal property is woefully inadequate when measured against contemporary commercial financing needs and practices. First, the applicable legislation reflects 19th century attitudes which regarded nonpossessory interests in personal property as something akin to fraud. Obviously, conditions have changed greatly. Secondly, there is a bewildering maze of different security de-

vices which, for historical reasons, have developed independently despite a similarity of economic function. This has led to a mass of technical rules, with different requirements for different security devices, which has no rational basis. Finally, the existing law produces unfair results. Secured parties are needlessly at peril, not for any reasons of social policy, but only because the law has failed to keep pace with developments in secured financing.

In this Report we recommend that a new and comprehensive personal property security Act be introduced to replace most of the present law which governs security interests in personal property.

CHAPTER I INTRODUCTION

A. The Purpose of Security Interests

People in all walks of life frequently feel the need or the desire to obtain the use of commodities despite a present inability to pay for them. Need and desire may outstrip the capacity to pay. In such a case, a person may seek to obtain credit. Credit involves the willingness of a person (the creditor) to make a loan to the person seeking credit (the debtor). The creditor hopes and expects that the debtor will repay to him the amount of the loan, usually with an additional amount to compensate the creditor for allowing the debtor use of the money. This additional amount generally takes the form of a percentage annual rate of interest on the loan.

But advancing money in the form of a loan is a risky business. The debtor may not be able to repay the loan; he may go bankrupt; and although it appears to the creditor that the debtor would have sufficient assets to discharge the loan, it may transpire that there are a dozen other creditors all claiming repayment of similar amounts. A person with substantial liquid assets at his disposal might be quite willing, in principle, to lend money in return for the interest the debtor is prepared to pay him, but in practice he will often only be prepared to do so if some way can be found of minimizing the risk that he will never see his money again.

The grant of a security interest to the creditor in certain assets belonging to the debtor is an attempt to reinforce the creditor∗s prospect of receiving repayment of the loan. In essence, what the creditor gets is a right to reimburse himself out of these assets if the debtor fails to pay. The creditor∗s right to a charge or lien on particular assets of the debtor if the creditor does not receive payment from the debtor is called a security interest.

Security interest take many forms, and may be classified in various different ways. Some, such as tax liens, mechanics∗ liens, and liens of the Workers∗ Compensation Board, are created by statute. Others, such as the liens of innkeepers, solicitors, and artificers, are created under the common law. Still others, such as the mortgage, conditional sale, and pledge, are created by express agreement between the parties. Some security interests are given in respect of personal property, others in respect of real property. Some are given to secure a sum owed by the

debtor to a person who supplied goods (vendor credit), others are given to secure a sum advanced to the debtor to enable him to purchase goods or services (lender credit).

In this Report we propose to consider the law relating to security interests in personal property created by agreement between the parties. Throughout, the term "security interest" is used, and by this we mean a consensual personal property security interest, unless the expression is qualified in such a way as to indicate some other meaning.

B. Security Interests in the Present Law

In the course of several centuries of common law development and a century of statutory intervention, various techniques of creating security interests have come to be recognized. The difficulties and disadvantages of the present law can only be understood in the light of the limitations which these techniques impose upon the creation of a security interest. We therefore give a summary account of security interests and the present law.

1. THE CONDITIONAL SALE

Under a conditional sale agreement, the seller reserves title to the goods until the condition specified in the agreement is satisfied. Where a conditional sale agreement is used as a security device, the condition required to be satisfied is invariably payment of the price. Conditional sale agreements are regulated by the *Conditional Sales Act.* The conditional sale must be registered at the office of the Registrar-General or, if the buyer is a corporation and the goods are not a motor-vehicle, at the office of the Registrar of Companies.[2] Failure to register within 21 days of the signing of the conditional sale agreement [3] renders the seller∗s security interest void as against, *inter alia,* a trustee in bankruptcy, execution creditors, and bona fide transferees for value.[4]

2. THE CHATTEL MORTGAGE

A chattel mortgage is the transfer of title to the mortgagee for the purpose of securing a loan by the mortgagee to the mortgagor. Possession of the mortgaged property generally remains with the mortgagor, although this is not necessary. Under the *Bills of Sale Act*[5] a chattel mortgage must be registered at the office of the Registrar-General or, if the mortgagor is a corporation and the subject-matter is not a motor-vehicle, at the office of the Registrar of Companies.[6] Failure to register within 21 days after making a bill of sale[7] renders the mortgage void as against, *inter alia,* a trustee in bankruptcy, execution creditors, and bona fide transferees for value.[8]

3. THE PLEDGE

Under a pledge, the owner of goods (pledgor) gives possession of the goods to a pledgee as security for a loan. Title to the goods remains in the pledgor, but the pledgee may retain possession until the sum owing to him is paid. There is no registration requirement for the valida-

tion of a pledge as against parties claiming an interest in the goods, execution creditors of the pledgor, or the pledgor∗s trustee in bankruptcy.

4. THE FLOATING CHARGE

The floating charge is an interest in corporate property granted to a lender, generally a debenture-holder, which attaches or "crystallizes" on the happening of certain defined events. Prior to crystallization, the company is free to deal with the property subject to the charge in the ordinary course of business. Once the charge crystallizes, it becomes a fixed charge. Subject to the provisions of the debenture, the charge generally crystallizes on the liquidation of the company, or on the debenture-holders taking possession of the property charged or appointing a receiver.

5. THE ASSIGNMENT OF BOOK DEBTS

> ln many situations, a person seeking credit may find that his most valuable and liquid asset consists of receivables due from his customers who have themselves bought on credit. These receivables may be assigned to a financer [9] as security for an advance. Under the *Assignment of Book Accounts Act,* an assignment of book accounts must be registered at the office of the Registrar-General, or, if the assignor is a corporation, at the office of the Registrar of Companies. Failure to register within 21 days of the assignment renders the assignment void as against the assignor∗s trustee in bankruptcy, execution creditors, and bona fide transferees for value. Certain assignments of debts are excluded from the registration requirement, notably assignments of "a debt or debts due at the date of the assignment from a specified debtor or specified debtors" and of "a debt or debts growing due or to grow due under a specified contract or specified contract5."[16]

6. ASSIGNMENTS UNDER SECTION 88 OF THE BANK ACT (CAN.)

Under section 88 of the *Bank Act* (Can.), banks are authorized to take security interests in a wide range of items which are so defined that the over-all effect is to authorize the banks to grant secured financing to industrial manufacturers, farmers, and fishermen and to wholesalers and shippers of natural products. The agreement granting the security interest need not be registered, although a "Notice of Intention" in the appropriate statutory form must be registered in the provincial office of the Bank of Canada. This document is required to be signed by the debtor and simply records the fact of the debtor∗s intention to grant a section 88 security interest, together with the debtor∗s name and address.

7. THE LEASE

In most people∗s minds, a lease is usually associated with real property. In recent years, however, the practice of obtaining the use and possession of certain types of goods under a lease has become common. The lease is most commonly used in connection with the financing of a transfer of equipment. There are no registration requirements, although if an option to purchase the goods is given to the lessee, the transaction is a conditional sale and requires registration accordingly.

C. Difficulties of the Present Law

The present law of personal property security suffers from a number of difficulties. The most obvious of these is the bewildering complexity and lack of systematization of the law. This appearance of disarray stems from the fact that our legislators and judges have never accepted the notion of a security interest in personal property as a functional and conceptual unit of reckoning. Different security devices have grown up, each with its own set of technical rules. This growth has been fostered by a preoccupation with matters of title. The question of who had title and what happened to it has been taken as the determinant of the kind of transaction that was involved, and hence as the determinant of what set of technical rules were the right ones to apply. The functional unity of the security interest has been overlooked as judges and legislators, when considering one form of security device, have allowed themselves to become insulated from developments that have occurred in respect of other security devices. Despite the similarity of economic function of each of those devices, there has been no comprehensive and systematic review of the law of personal property security as a whole. In the final result, the present law consists of a mass of technical rules, with different requirements for different security devices.

This failure to perceive and act on the functional unity of the security device has given rise to considerable problems, particularly with respect to wholesale financing. Many of these problems have been discussed and analysed by leading commentators in the field of personal property security law. A full elaboration would require a work of considerable scope. Here, we list a few of the difficulties which we have encountered.

The *Bills of Sale Act* and the *Conditional Sales Act* contain no special provisions relating to wholesale inventory financing. The significant feature of inventory financing is that it presupposes a long-term relationship between the parties, with new inventory being obtained by the dealer from time to time as his old stock is sold off. The amount of the indebtedness will vary from time to time as and when the dealer accounts to his financer with the proceeds of a sale, and as the financer makes new advances to facilitate the purchase of new stock. This kind of relationship between dealers and financer must be carried on with a minimum of formality. To be effective in regulating this type of transaction the law must be able to provide for a continuing security interest, in favour of the financer, against a mass of shifting collateral. The law must permit future advances to receive the protection of the security interest, permit the financer to follow his interest into the proceeds of collateral, and permit the security interest to embrace after-acquired collateral, all with a minimum of formality. On these matters the present law is deficient.

It is not clear in many instances how effective are security interests involving future property and future advances. In some instances, for no clear reasons of policy, such interests cannot be created at all because of the conceptual limitations which surround a particular security device. In other cases the creation of such security interests is either precluded or made unnecessarily difficult by the formal requirements of the relevant legislation. Where, for example, it is

intended to supply inventory to a dealer on a continuing basis, a new conditional sale agreement must be executed and registered for each lot of goods supplied. The conditional sale agreement is conceptually inappropriate for including future goods which have not been agreed upon, and the description requirements involved in registration preclude the possibility of including all future goods in a single agreement. Theoretically, the chattel mortgage can embrace future goods, but when the future goods are acquired by the dealer the secured party∗s interest remains vulnerable to later legal interests under the rule in *Holroyd* v. *Marshall.* Moreover, the status of future advances is not clear under our chattel mortgage legislation. The result is that an effective security interest in inventory is difficult to achieve in the uncongenial climate of the present law.

Another feature of the present law is that it is impossible to combine different forms of security arrangement in a single transaction with a single act of registration. If a manufacturer wishes to borrow from a single lender on the security of his inventory and his accounts receivable, under Provincial legislation two separate agreements and acts of registration are required. Again, in some instances a particular transaction may be capable of expression either as a conditional sale or a chattel mortgage, but attendant formalities, as well as substantive rights and remedies, will differ according to which form is adopted. It is hard to find convincing reasons of policy for anomalies of this kind. In some instances the growth of new patterns of secured financing has been inhibited by the stranglehold that existing security devices have gained. Thus, the trust receipt, a financing device well-recognized in the United States and in England, has been held to be a mortgage in Canada and, as such, has been robbed of its efficacy. In other instances, transactionswhich may have a security function, such as the sale on consignment and the lease, have escaped regulation because they did not fit into the technical framework of the separate security devices.

In addition to the difficulties of substance inherent in the present law, the various requirements of formality are also a fruitful source of problems. Mr. Fred Catzman, Q.C., of the Toronto Bar, said in 1967 in the course of the W. C. J. Meredith Memorial Lectures:

> It is routine practice for the trustee in bankruptcy to instruct his solicitor to examine the validity of security documents given by the bankrupt. The most profitable inquiry, particularly in the case of chattel mortgages, has been not in the area of fraudulent preference, as one might expect, but rather to search for technical flaws that contravene the formalities prescribed by the Act.

Another consequence of the growth of the separate security devices has been that there is no over-all scheme of priorities as between one device and another. Each security device has developed in its own context, with attention being directed at the requirements, whether legislative or common law, for obtaining an enforceable security agreement. Little explicit attention has been paid to resolving priority between two apparently enforceable interests.

It would be wearisome to itemize the multitude of particular problems which reflect the law∗s failure to keep pace with the practical developments relating to secured financing. Specific examples may be of assistance in focusing on the problems. Here are but a tiny sample:

(1) As stated above, the ability to provide for future advances is an important element of modern inventory financing. The *Bills of Sale Act* is silent on whether a mortgagor of chattels may grant security in respect of an advance to be agreed upon and made in the future. Is the implication that what the Act does not outlaw is permissible, or that what the Act does not sanction is prohibited? Section 3 of the Act, which is titled "Attestation," requires that a bill of sale "set forth the true consideration for which it was given." Since where future advances are involved (except those made pursuant to prior commitment) it is impossible to specify the consideration at the time of grant, does this mean that the Act prohibits future advances? Can requirements of formality be allowed to dictate the scope and operation of the substantive law? Is there any rational policy ground on which such results can be supported?

(2) Another important feature of an effective personal property security law is its ability to provide for security interests in after-acquired property. It cannot be done at all under a conditional sale agreement since the structure of such a transaction would be incompatible with an interest in future goods, and it is unclear how far this can be done under present mortgage law. The *Bills of Sale Act* provides, in section 3 (2), that "where a bill of sale comprises a motor-vehicle," the serial number of the vehicle must be registered. But, unlike other Provincial statutes, there is no general requirement that there be "a sufficient and full description of the goods." One of the difficulties with security interests in future goods is satisfying the requirements of description, since no particular items are available to be described at the time of execution of the security agreement and registration of the security interest. Is the effect of our Act that, generally speaking, security interests in after-acquired property are permissible, motor-vehicles being an exception? Or would other kinds of goods capable of description by item, such as through a serial number or manufacturer∗s identification number, be treated by analogy with motor-vehicles? Or are security interests in future goods to be regarded as forbidden since the Act does not expressly sanction them? (3) Even if, in general, security interests in after-acquired property are permissible, there are other difficulties with them. The mortgagee∗s registration is not generally regarded as notice to third parties. Moreover, when the future goods are acquired by the mortgagor, the mortgagee gets, at most, an equitable interest in them and hence is vulnerable to later innocent legal interests. This difficulty first emerged in English 19th century case law relating to the assignment of future book accounts and goods. With regard to accounts, this is no longer a problem in British Columbia due to the combination of sections 2 *(e)* and 14 of the *Assignment of Book Accounts Act,* which in part do away with the rules in *Holroyd* v. *Marshall* [20] and *Dearle* v. *Hall.* While this is a useful development, the law is left in the anomalous position that registration under the *Bills of Sale Act* is not notice, whereas registration under the *Assignment of Book Accounts Act,* broadly speaking, is notice. To complete the lack of coherence of this picture, no after-acquired property interest may be granted as part of a conditional sale agreement. Thus, future inter-

ests seem to be reasonably secure as to accounts, of uncertain status as to mortgages of goods, and impossible as part of conditional sales of goods.

Clearly the law is in disarray and the inhibitions which it places on contemporary commercial financing do a disservice to the community as whole.

CHAPTER II REFORM OF THE LAW

A. Other Jurisdictions

In view of the unsatisfactory state of the present law of personal property security, the Commission has undertaken the task of recommending measures for its reform. Improvement of this particular area of law is by no means a novel idea. Many common law jurisdictions have recently accepted the view that their law of personal property security is in need of reform. In the United States of America, the law relating to personal property security has been thoroughly overhauled and is now to be found in the Uniform Commercial Code. The inspiration for this project came from Karl Llewellyn, one of the greatest and most thoughtful American legal scholars of this century. He began work in the 1930∗s on the project that ultimately ripened into the Uniform Commercial Code. In the course of its development the project came under the auspices of the American Law Institute. The Code is a codification of almost the entire body of commercial law. Article 9 of the Code relates to personal property security. The Code was first adopted by a few states during the 1950∗s, and has now been adopted by all the states except Louisiana. The preparation of Article 9 involved many years of careful and painstaking work on

the part of leading scholars and practitioners in the field in the United States. For any one concerned with reform of this branch of law, it is an effort of paramount importance.

In Canada, Ontario and Manitoba are, so far, the only provinces to have reformed their laws. In 1960 a Committee was formed in Ontario under the chairmanship of Mr. Fred M. Catzman, Q.C., of the Ontario Bar. After four years* work that Committee[1] produced a draft bill. The work of the Catzman Committee was sponsored by the Attorney-General for Ontario and received the co-operation of the Canadian Bar Association. The draft bill was published by the Ontario Queen*s Printer in 1964.

The Catzman Committee bill was then referred by the Attorney-General for Ontario to the Law Reform Commission of Ontario for its views and recommendations. The Ontario Commission produced two reports, one in 1965 and the second in 1966, recording its recommendations. The Ontario Commission*s Report differed in detail from the Catzman Committee bill, but as to the vast bulk of recommendations, the two reports were similar. A bill to implement the recommendations of the Ontario Law Reform Commission was then introduced into the Legislature and became the law of that province under the title *The Personal Property Security Act, 1967*. That Act was amended in 1973 by *The Personal Property Security Amendment Act, 1973*. The two Acts have not yet been proclaimed in force. The reason for this delay seems to be the very great difficulty that has been encountered in Ontario in establishing a centralized, computerized, registration system. The necessary steps toward implementation are, we understand, being taken.

The Ontario Act bears a very close resemblance to Article 9 of the Uniform Commercial Code. The Catzman Committee adopted all the major conceptual and structural aspects of Article 9 and these were retained by the Ontario Law Reform Commission and the Legislature.

In 1963, meanwhile, the Commercial Law Section of the Canadian Bar Association established a special committee to make recommendations with respect to the advisability, and the form and content, of a Uniform Act on Security in Personal Property. The first chairman of this committee was the Honourable R. L. Kellock, Q.C., and Professor Jacob Ziegel was appointed his secretary. In 1966 Professor Ziegel became Chairman of the Committee.[4] The Ziegel Committee presented a draft Act, together with comments, to the 1969 annual meeting of the Commercial Law Section. In view of the limited time between publication of the draft and the convening of the meeting, the Ziegel Committee agreed to present a further draft of the Act at the next annual meeting, thereby giving provincial subsections and other interested parties an opportunity to study the draft. In 1970 the Ziegel Committee presented the "Model Uniform Personal Property Security Act" and it was approved and adopted by the Canadian Bar Association in that year. Throughout this Report we refer to that draft as the "Model Act," or simply "the Act."

In 1971 a draft of the Act was submitted to the Conference of Commissioners on Uniformity of Legislation. The draft adopted by the Conference we refer to as the "Uniform Act."

The Manitoba legislation [6] is of relatively recent origin. Our basic research had been completed and much of this Report written at the time that legislation emerged. We therefore offer no extensive comment on it and mention at this point for the sake of completeness only.

To summarize, there are currently six drafts of the Act in circulation in Canada. These are the Catzman Committee Report, the Ontario Act, the Manitoba Act, the Model Act, and the Uniform Act. All rely heavily on Article 9 of the Uniform Commercial Code, although they diverge from the Code on many points of significance and they differ from one another on some
important points of detail.

In other common law jurisdictions, the process of reform has not advanced this far. England seems to be the other major common law jurisdiction in which reform is likely in the forseeable future. In 1968 a Committee was established in England under the Chairmanship of Lord Crowther to inquire into, and make recommendations with regard to, the law and practice governing consumer credit. The Committee construed its terms of reference widely, however, and recommended adoption of a statute dealing with the lending and security aspects of credit generally, whether the underlying transaction was a consumer or a business one. In dealing with the security aspect of lending, the Committee drew heavily on Article 9 of the Uniform Commercial Code and considered *The Personal Property Security Act* of Ontario. The Crowther Committee did not accompany its report with a draft statute, but it made many recommendations of principle bearing a close similarity to the principles underlying Article 9 and the Ontario Act. No action has so far been taken on the security aspect of the Crowther Committee Report.

B. The Commission∗s Position and Approach

On the general question whether reform of the law would be appropriate at this juncture, the Commission has no reservations. The present law is antiquated, obscure, difficult, and produces many anomalies. In addition, the fact that the general movement among leading common law jurisdictions is toward active reform makes this an opportune time for British Columbia to take a similar step, particularly in view of the very detailed and thorough work which has recently been done in those jurisdictions.

Article 9 of the Uniform Commercial Code has been so highly acclaimed in the United States, Ontario, and England that it would be folly to ignore it. The approach we have decided to adopt is to take one of the Canadian versions of Article 9 and examine its provisions from a general conceptual and policy viewpoint and in matters of detail and drafting; and to determine how suitable it would be for adoption in British Columbia.

The Commission has had the good fortune to be advised in this project by Messrs. C. P. Daniels, Q.C., H. C. Cameron, and M. H. Gropper of the Vancouver Bar, and latterly by Professor R. Cuming of the Faculty of Law, University of Saskatchewan, and by Professor C. Carr, formerly of the Commission∗s staff, now of the Faculty of Law, University of Toronto. At their

suggestion, we have chosen the draft of the Ziegel Committee (the "Model Act") as our starting point, although this has not been because of an innate preference for that particular draft. The reason is that one member of our team of advisers, Mr. C. P. Daniels, Q.C., was a member of the Ziegel Committee and Professor Cuming was its secretary; our consultants were all familiar with that draft, and the Model Act seemed, therefore, an obvious place to start. In the event, little turns on this matter, since we have always given close consideration to the other drafts and have generally cited and discussed points of difference between the Model Act and other drafts.[8]

It has been the usual practice of this Commission to circulate a document for discussion, in the form of a working paper, containing tentative conclusions and proposals for reform. These proposals are normally reviewed in the light of comment and criticism received and a final report prepared on that basis. We had, until recently, contemplated taking the same approach in this project. At the conclusion of our research, however, a number of points clearly emerged which caused us to reconsider our view.

First, we do not pretend that personal property security legislation, based on Article 9, is simple to grasp. To the person who encounters it for the first time it may seem to bristle with complexity and difficult concepts. To appreciate its underlying logic and utility requires hard work. Bearing this in mind, it seems unrealistic to give wide circulation to a working paper and call for immediate response. We fear that the necessarily tentative language of a working paper would cause some to misdirect their resources to a rejection of the Article 9 approach rather than toward commenting on matters of detail in which consultation would be useful. Our commitment to the Article 9 approach is far stronger than tentative and a working paper would be misleading.

Secondly, substantial consultation has already occurred. We take as our starting point the collective view of the organized bar. That is the Model Act which has been approved and adopted by the Canadian Bar Association. Added to that is the advice of our consultants, all of whom are considerably experienced in contemporary developments in commercial law.

Finally, the fact that we have proceeded to a final Report on this topic does not mean that the form of any legislation which may finally emerge need necessarily reflect our recommendations in every respect. The Ontario experience demonstrates that some delay between enactment and proclamation is inevitable while the necessary registry machinery is being prepared.[9] This would allow time for comments and suggestions to be made and incorporated in the legislation through appropriate amendments. Alternatively, legislation could be introduced and given first reading, but then allowed to lapse. In a succeeding session a new bill could be introduced, reflecting the comment attracted by the first. That was the technique used in the introduction of the new British Columbia *Companies Act,* and it seemed to work well.

We wish to stress one final point at this stage. Personal property security legislation such as we recommend in this Report is morally and politically neutral in concept. It does not restrict or otherwise impinge on the rights of one group of persons in favour of another. Its primary aim

is to rationalize a highly technical area of the law which is filled with anomalies and absurdities, and to clarify the relationship between businessman and businessman.

We are alive to the possibility that new legislation may cause some shift which favours large businesses over small, although it is difficult to make any prediction with certainty. First, large businesses may have the resources which smaller businesses lack, to take the fullest advantage of the legislation at an early stage. Secondly, small businesses are more likely to be unsecured creditors. A possible result of the legislation is that a greater percentage of credit extended will be secured. Thus, in the event of an insolvency, less will be left for creditors who are unsecured and that status will be more disadvantageous than before.

There may also be areas in which the legislation might affect the relationship between the businessman and ordinary citizens. Here considerations of "consumer protection" arise, and these are the subject of discussion in a separate chapter of this Report.

C. The Format of the Report

In the text of this Report we have divided the topic up into sections. These divisions correspond broadly to the arrangement into parts of the Canadian drafts and of Article 9. We have discussed the provisions of the different draft Acts topic by topic, rather than section by section. Whilst a section by section discussion makes for ease of reference, the important questions raised by the draft Acts are more conveniently and logically dealt with on a topic by topic basis.

It will be noted that there are a number of provisions in the Model Act which receive only passing reference and some which receive no comment at all. There are two reasons underlying this seeming omission. First, while extensive explanation is necessary to put the over-all concept of the Act and some specific provisions into perspective, we have not set out to write a textbook. That is not the function of a law reform body. A full exposition of the Act would far outstrip our resources and would not amount to a significant contribution to the already enormous literature on Article 9 and its variations. Second, in most cases, the provisions which are not the subject of comment are relatively clear and any textual treatment would be little more than a repetitious setting out of those provisions. In all such cases it may be taken that the Commission agrees with the policy and language of the Model Act.

We have not been able to append drafts of all the various efforts to produce a new Act that now exist. We have, however, set out the Model Act in the appendices to this Report. In addition, in the text of the Report we have cited many provisions from the other Canadian drafts and from Article 9. We are confident that we have given adequate coverage to the various alternative provisions contained in the different Canadian drafts and to the significant differences that exist between the American and Canadian versions.

In the Appendix containing the Model Act we have also set out the provisions which reflect our recommendations where we feel a departure from the Model Act is called for. Thus, an

inspection of that Appendix will enable the reader to immediately ascertain where, and in what fashion, we differ with the Model Act.

Throughout the Report, as mentioned above, references to the "Act" are to the Model Act as adopted and approved by the Canadian Bar Association; references to the "Code" are to Article 9 of the Uniform Commercial Code; references to the "Catzman Report" are to the "Draft Bill" produced by the Catzman Committee and entitled "An Act to reform and make uniform the law regarding Security Interest in Personal Property and Fixtures," references to the "Uniform Act" are to the Uniform Personal Property Security Act submitted to the Conference of Commissioners on Uniformity of Legislation in Canada; and references to the "Ontario Act" are to *The Personal Property Security Act, 1967* as amended by *The Personal Property Amendment Act, 1973.*

To provide a logical framework for other recommendations made in this Report, we now make the following recommendation.

The Commission recommends:

The Model Act, as adopted and approved by the Canadian Bar Association, subject to other recommendations made in this Report and set out in Appendix A, be enacted in British Columbia.

CHAPTER III AN INTRODUCTION TO THE MAIN FEATURES OF THE ACT

A. The Concept of a Security Interest

Perhaps the most striking feature of the Model Act is its attempt to recognize and reflect the functional unity of the various different security devices that exist under the present law. Under the Act, it does not matter whether you are a conditional seller, a chattel mortgagee, a pledgee, or the holder of rights under some more complicated form of security device. What you receive is a security interest and the various rules relating to the creation of the interest, to the rights and remedies to which the interest entitles the holder, and to priority, all apply. The security interest is thus the central concept of the Act and whether the circumstances of creation of the interest suggest what we now might call a conditional sale, or a chattel mortgage, or something else, is of little significance under the Act.

That is not to say that it is no longer possible to enter into a conditional sale or chattel mortgage; it is simply that no significance attaches to whether the transaction is one of the one type or the other, or of some third type.

B. The Act*s Terminology

The Act adopts quite a new, though not completely unfamiliar, terminology. The central concept, the security interest, has already been mentioned. The person in whom the security interest is vested is called the "secured party" and the person who owes the obligation for which the security interest is security is called the "debtor." The thing in which the secured party has an interest in is the "collateral." Thus we have a secured party with a security interest in collateral to secure performance of an obligation by the debtor.

The expression "collateral" covers any kind of personal property in which the secured party has a security interest. But the Act, in addition, creates a classification of the various different kinds of collateral. Thus there are security interests in goods, documents of title, instruments (bills of exchange, promissory notes, and cheques), securities (shares, stock warrants, bonds, debentures, debenture stock, etc.), chattel paper (a technical term meaning, typically, a retail conditional sale agreement or chattel mortgage), and intangibles (a catch-all term which includes any personal property not falling within the previously mentioned species of collateral).

Within this scheme there is also a subclassification. Goods are divided into three categories of their own. They may be inventory, equipment, or consumer goods. The core idea of these terms is conveyed by the name, but they are defined in section 1 of the Act and the definition needs to be consulted for the more doubtful cases.

Two other terms that appear throughout the Act, and are of the utmost importance, are "attachment" and "perfection." The former corresponds broadly with the idea of creating a security interest. Thus, according to section 12 of the Act:

(1) A security interest attaches when
- *(a)* the parties intend it to attach;
- *(b)* value is given; and
- *(c)* the debtor has rights in the collateral.

Paragraph *(a)* is simply a reflection of the fact that the security interest regulated by the Act is consensual in nature. "Value," referred to in paragraph *(b),* is defined in the Act. Section 1 (g) provides:

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

Before a security interest can attach, the secured party must have given value. Generally, this will mean the secured party has made an advance of funds, but a commitment to make such an advance, or indeed to do any other act, is clearly sufficient in the light of the definition of value.

The third requirement for the attachment of a security interest is that the debtor have rights in the collateral. A security interest is an interest in property. Clearly the debtor cannot grant interests in property unless he himself has an interest to grant. This is the thrust of paragraph *(c)*.

It will be seen from this that in most situations the notion, not always made precise, of "creation" will correspond with the Act∗s concept of attachment. The parties have freedom to determine when the security interest should come into being; until the debtor receives some form of value, there is no obligation to secure; and until the debtor has something in which to grant a security interest, he cannot grant one.

The other term mentioned above, "perfection," means taking the steps necessary to put the security interest in a position of strength *vis-a-vis* other parties who claim an interest in the collateral. That is to say, it is about priority. Perfection may be achieved in one of two ways, and it is at this stage that the classification of collateral into goods, documents of title, instruments, etc., begins to take on significance. The two methods of perfecting a security interest are

(1) registration of the interest against the name of the debtor; or
(2) taking possession of the collateral.

In the case of some types of collateral, such as goods and chattel paper, the security interest can be perfected either by registration or by taking possession of the collateral. In other cases the security interest may be perfected by only one of the two methods. The principle behind this is that, where the collateral has some of the attributes of negotiability, the only sufficient method of perfection is by taking possession. Thus, according to section 24, a security interest in instruments, securities, and negotiable documents of title may only be perfected by taking possession.

In cases where the security interest may be perfected by registration only and not by possession, this is generally because the collateral in question has no physical or documentary existence. Thus, intangibles generally have no physical aspect. The most common form of an intangible, and one that is extremely important in the personal property security field, is a debt. It is apparent, therefore, why a security interest in such an intangible cannot be perfected by taking possession, but only by registration.

C. The Act∗s "Floating Lien"

The floating charge is a familiar creature of our company law. It enables the chargee to obtain a security interest which attaches to the debtor∗s entire undertaking. The debtor is free, in the ordinary course of business, to dispose of assets which are charged, but the floating charge attaches to whatever new assets are acquired by the debtor from time to time. Thus, after-acquired property and proceeds may be charged without the need for additional formality as and when such items of collateral are acquired by the debtor, and the charge may also constitute security for future advances.

The "security interest" created by the Act has many of the attributes of a floating charge. It may be granted against future advances and it may cover after-acquired property and proceeds, and, in view of this great flexibility, it is common in the United States to refer to the security interest as creating a "floating lien" or a "continuing general lien."

In the United States, certain aspects of the continuing general lien were frowned upon by the courts. The doctrine enunciated by Brandeis J. in *Benedict* v. *Ratner* that a person could not have an interest in property if he did not exercise sufficient "domination" over that property rendered impossible the creation of continuing general liens without the secured party adopting a sophisticated system of "policing." Article 9 of the U.C.C. is therefore a significant innovation, for it permits the continuing general lien without the legal necessity of any "policing" whatsoever.

In Canada, with a long history of the floating charge, and no doctrine such as *Benedict* v. *Ratner* requiring that the debtor be made to account for the various items of collateral to the secured party, there is less of a sense of innovation about the continuing general lien.

D. The Act∗s Priority System

It has already been mentioned that the central feature of the Act is that it embodies a single, uniform concept known as a "security interest" and each of the different devices, such as conditional sale agreement, chattel mortgage, and pledge, falls within and is regulated by the Act. Consequently a single system of priority rules is sufficient to resolve conflicts which under the present law can pose virtually insoluable problems. To be sure, the Act∗s priority rules are complex, but they are technically, and as a matter of policy, a vast improvement on the present law.

The priority system contained in the Act is a sophisticated one. Many of the rules are designed for specialized situations and will not be encountered in everyday practice. The most striking aspect of the priority rules, however, is their thoroughness, and this, in such a complicated area of law, is a valuable commodity.

E. The Act's Registration System

Registration is one of the two ways in which a security interest may be perfected. Traditionally, provincial registration systems have involved compliance with a large number of technical and formal requirements, particularly under the *Bills of Sale Act.* It is doubtful whether the formalities required by that Act, and other Acts, did very much to curb the likelihood of fraud, which was their presumed justification. There is clear evidence of a modern tendency to do away with formality unless it can be shown to have a purpose whose attainment is likely to be advanced by the requirement of formality. Thus, in British Columbia, the requirement that affidavits of bona fides be registered has been repealed.

The registration system of the Model Act follows the approach of eliminating unnecessary formality. The Act contains a provision (section 47) drafted in two alternative ways setting out what must be registered in order to perfect the security interest. Alternative A of section 47 adopts the principle of notice filing, as opposed to transaction filing. The significance of the distinction lies in the fact that, for transaction filing, it is necessary to register a copy of the security agreement itself, setting out the terms and conditions. In the case of notice filing, the document that is registered must identify the collateral that is subject to a security interest, but it need not contain the terms and conditions of the security agreement itself.

Alternative B of section 47 opts partly in favour of notice filing and partly in favour of transaction filing. As to security interests in inventory and accounts, notice filing is sufficient; otherwise a copy of the security agreement must be registered.

One consequence of the registration system and the ability of the parties to provide for future advances in the security agreement is that it may be impossible to tell from the state of the register the extent of the debtor∗s indebtedness to the secured party. A search conducted in the registry against the debtor's name will reveal the name of the secured party, and indicate the collateral subject to a security interest. Any further information required by a person contemplating making a loan to the debtor will have to be obtained from the parties themselves. Accordingly,

section 20 of the Act gives the debtor (and, incidently, and "execution creditor or other person with a legal or equitable interest in the collateral") the right to obtain from the secured party a statement specifying the amount of the indebtedness, a list of the items of collateral, and a copy of the security agreement.

F. The Act's Code of Remedies

Part V of the Act creates a code of rights and remedies applicable on default by the debtor. The parties may still provide what is to happen in the event of default, and any additional rights and remedies given to the parties by the security agreement and not contained in the Act's code of remedies are effective, subject only to the fact that certain rights and remedies given to the debtor under the Act cannot be waived. Thus, the general principle of freedom of contract that runs through the Act carries over into the area of remedies, except that certain rights cannot be invaded in the name of freedom of contract when they are intended for the protection of the debtor.

The kinds of remedies granted to the parties are familiar. Upon the debtor∗s default, the secured party may take possession of the collateral. He may also dispose of the collateral and apply the proceeds to the cost of his expenses, the amount of the indebtedness and in satisfaction of a subordinate security interest. In certain circumstances, the defaulting debtor is given a right to redeem the collateral or to reinstate the security agreement.

CHAPTER IV SECURITY INTERESTS AND THE SCOPE OF THE LEGISLATION

A. Introduction

The Act applies to "security interests"; thus when a something falling within the Act's definition of that term is found to exist, the Act determines its attributes, such as its priority position and the rights and remedies of the parties. The phenomenon which triggers the Act is the existence of a security interest. The first question requiring detailed examination is, therefore, the definition of "security interest." To what manner of creature does the Act apply?

B. The Definition of "Security Interest"

The expression "security interest" is used in the Act in a technical sense and it includes both the things that are commonly understood to be security interests in personal property and other classes of interest that would not normally be thought of as being security interests. Section 1 (y) provides:

"security interest" means and includes

(i) an interest in goods, documents of title, instruments, securities, chattel paper or intangibles that secures payment or performance of an obligation;

(ii) an interest arising from an assignment of accounts or chattel paper not intended as security, other than an assignment under the *Assignments and Preferences Act.*

C. The Conventional Security Interest

The categories of collateral referred to in paragraph (i) of this definition include all types of personal property. All the various forms of property referred to in paragraph (i) are defined in the Act, but it is worth setting out the definition of "intangible" because of its "catch-all" nature. Section 1 *(m)* provides:

> "intangible" means all personal property, including choses in action, that is not goods, chattel paper, documents of title, instruments or securities.

Reading this definition along with paragraph (i) of the definition of security interest cited above, paragraph (i) might be paraphrased as follows: "security interest means an interest in any personal property that secures payment or performance of an obligation."

This limb of the definition of a security interest is clearly intended to reproduce the conventional understanding of a security interest in personal property. Its strength as a definition is limited. Unless the reader already knows what a security interest is, he is unlikely to derive much assistance from the definition, since in order to be a "security interest," the "interest" must "secure" the carrying out of an obligation. But the Act is of no help in determining when an interest secures something. The definition tells us what range of secured things fall within the Act ("payment or performance of an obligation") and it tells us what range of interests may constitute security (an interest in any personal property). But it does not tell us the nexus that must exist between the two or, in other words, when does an interest in personal property "secure" an obligation

This is an example of the difficulty of starting with a clean slate, even in the context of a piece of codifying legislation. In fact, it would be a very difficult and perhaps a dangerous task to try and define the required nexus in order fairly to say that the interest "secured" performance, and any further attempt at definition is unlikely to add to the usefulness of the provision.

A similar problem is posed by the fact that "personal property" is not defined for the purposes of the Act. Although various definition provisions tell us some kinds of things which are personal property (e.g., goods, chattel paper, documents of title, instruments, securities, and choses in action), the definition of "intangible" leaves the matter open-ended. Doubt as to whether or not something is personal property may arise in two ways. First, it may be questionable whether or not the interest in question is "property." Does "property" include a taxi operator∗s licence or "quota" under a marketing board scheme or a forest tenure? Secondly, there may be some doubt as to whether property is "personal" as opposed to "real." Some property interests may have aspects of both.

With respect to both of these "grey areas" we feel that better results are likely to be achieved by a judicial consideration of concrete fact situations on a one-by-one basis than by an

attempt to create a definition in the abstract. In any event, the difficulties are more academic than real and in the vast majority of cases it will be clear whether or not "personal property" "secures" the performance of an obligation.

D. The "Deemed" Security Interest

The second limb of the definition of a "security interest" brings within the scope of the Act two types of transaction not normally thought of as creating a security interest. The two types of transaction are "an assignment of accounts or chattel paper not intended as security." If an assignment of accounts or chattel paper is by way of security, it falls within the first limb of the definition. The second limb therefore catches only nonsecurity assignments of accounts and chattel paper.

Account is defined in section 1 (*aa*). It provides:

"account" means any monetary obligation not evidenced by chattel paper, any instrument or securities;

Clearly the core of the concept of account is simply that of debt. Chattel paper is defined in section 1 *(c)*. It provides:

"chattel paper" means one or more than one writing that evidences both a monetary obligation and a security interest in specific goods;

This means basically that chattel paper consists of a piece of paper recording a debt secured by an interest in goods. The obvious examples of chattel paper are the interest of the seller under a conditional sale agreement and of the mortgagee under a chattel mortgage.

The effect of including nonsecurity assignments of those two kinds of collateral within the definition of a security interest is that even an absolute assignment of a debt, conditional sale agreement (both of which are very common transactions), or chattel mortgage (perhaps not such a common transaction) falls within the Act, and the incidents of the transaction, such as registration, priority, and remedies, are governed by the Act.

The inclusion of nonsecurity assignments of these forms of collateral calls for an explanation. We believe there to be two principal reasons for their inclusion. First, where the subject-matter of the assignment will eventually produce a fungible such as money it may be very difficult to know whether the assignment was by way of security or was absolute in nature. This is not so in the case of factoring, or nonrecourse notification financing where the assignee gives notice to the debtor of the assignment, and the debtor pays the assignee directly. But much financing, especially consumer financing, is done on a non-notification basis whereby the assignor collects the debt and accounts to the assignee. In such a case, it may be only the degree of rigour with which the assignee requires his assignor to account that differentiates a security from a nonsecurity assignment. This suggests that functionally there may be little difference between the security assignment in which the advance made by the assignee is liquidated out of moneys received by the assignor from the debts assigned and the absolute assignment in which the ad-

vance is liquidated when the assignor accounts to the assignee for the moneys he has collected from the debts assigned.

Second, and this is, perhaps, only a more generalized statement of the first reason, whether the transaction involves security or nonsecurity assignments, it remains a financing transaction. The question of whether the parties find one particular procedure for financing more convenient than another should not mean that a different set of rules will apply. This is particularly apparent in the area of priorities. If all of the major methods of inventory and receivables financing are brought within the same Act, conflicting interests in the same collateral can be resolved by a single set of priority rules.

If, however, one type of financing arrangement is included in the Act and another one left out in a situation where the two arrangements may often co-exist, the problem arises of working out of a set of meta-rules for determining the relationship between the Act∗s priority rules and the priority rules that exist under the general law. In fact, this must be done in any event for certain obvious cases of conflict between code and noncode interests.[4] But where the co-existence of a code and noncode interest is likely to occur in a case where the two interests also have a similar function, there is no point in making life more difficult than it already is by creating a new order of rules to link together the code∗s priority rules with the noncode priority rules; the most satisfactory procedure is to bring all of the functionally similar transactions within the same set of priority rules.

There are other reasons which might also be advanced for including nonsecurity assignments of accounts and chattel paper within the Act. The present rule of priority as to assignments of accounts and chattel paper is known by the name of the leading case, *Dearle* v. *Hall.* The rule in *Dearle* v. *Hall* gives priority, in a case of successive assignments, according to the order of notice received by the debtor. This rule has been quite widely criticized as a rule of priority, although it has a perfectly valid function in permitting the debtor to continue validly to discharge the debt by paying the assignor until he receives notice of an assignment. But discharge of the debt is a matter quite different from priority between successive assignees.

The priority of the rule in *Dearle* v. *Hall* is unsatisfactory. It requires the debtor to act as the public notice system for potential assignees. This function should be transferred to an officially administered system just as, in the case of other kinds of interests in and charges against property, there are public notice systems. The adoption of a general statute regulating public notice and priority as to security interests in personal property provides the occasion for including certain nonsecurity interests where the same kind of system would be an improvement on the present law.

Again, there are many uncertainties and difficulties in the present law of assignments of accounts, particularly with regard to such fundamental matters as after-acquired property and future advances. A further advantage of bringing nonsecurity assignments within the

Act is that they will then receive the benefit of the various provisions in the Act which relate to those types of interest and the priority surrounding them.

We believe, therefore, that the inclusion of accounts and chattel paper within the scope of the Act is desirable. We also point out that section 2 *(b)* of the Ontario Act has included "every assignment of book debts not intended as 'security'." The report of the Ontario Law Reform Commission indicates why this was done in Ontario. The reasons advanced are

(1) dissatisfaction with the *Assignment of Book Debts Act;*
(2) the need for an alternative system of registration;
(3) the difficulty of distinguishing absolute and security assignments in some cases; and
(4) uniformity of law between Ontario and the U.S.A.

In British Columbia the relevant statute is the *Assignment of Book Accounts Act.* It is a difficult statute and its demise and replacement by a personal property security statute would be no cause for regret.

The Ontario Act does not specifically include absolute assignments of chattel paper. Chattel paper, however, consists of two elements—a debt and a security interest in specific goods. The debt aspect of an absolute assignment of chattel paper is presumably intended to be caught by the inclusion of absolute assignments of book debts of the Act. While an assignment of the security interest aspect of chattel paper does not seem to fall within the Ontario Act, this does not matter unduly since in most cases the two constituent elements of chattel paper are likely to be assigned together.

We do not, however, believe a distinction should be drawn between the debt and security aspects of chattel paper. It would appear to follow from such a distinction that, as between successive assignees of chattel paper, one set of priority rules would apply to determine priority to the accounts, but another set would apply to determine priority to the exercise of rights of repossession in the event of default by the debtor. In our view the priority position as to rights of possession should follow the priority position as to the account. We therefore favour providing expressly, as the Model Act does, that nonsecurity assignments of chattel paper are within the Act. We note that the Uniform Act and Article 9 also adopt this approach.

E. The Application of the Act

Apart from the definition of "security interest" contained in section 1 (y), which we have just examined, there is a general provision listing the kinds of creature to which the Act applies. This is contained in section 2. It provides:

> Subject to section 3, this Act applies
> *(a)* to every security agreement without regard to its form and without regard to the person who has title to the collateral that in substance creates a security interest, including, without limiting the foregoing,

(i) a chattel mortgage, conditional sale, equipment trust, floating charge, pledge, trust deed or trust receipt, and

(ii) an assignment, lease or consignment intended as security; and

(b) to every assignment of accounts or chattel paper not intended as security but not to an assignment for the general benefit of creditors to which the *Assignments and Preferences Act* applies.

This provision probably adds very little to the definition provisions of the Act since the terms "security interest" and "security agreement" have already been defined in the definition section. The definition of "security agreement" is contained in section 1 (x). It provides:

"security agreement" means an agreement that creates or provides for a security interest.

The function of section 2 is clearly to provide an indication in general and familiar terms of the kind of transaction embraced by the expression "security interest." Nothing of the strict meaning would have been lost if the section had ended at the words ". . . that in substance creates a security interest," although the expository function of the section would have been impaired. Clearly all the things listed in paragraph *(a)* are security interests; but it is reassuring to be told that they are. As to paragraph *(b),* it is simply intended to be a repetition of paragraph (ii) of the definition contained in section 1 *(y)* despite the slight change in the wording.

We believe that this exposition, stated in generally understood language, of what the Act*s new terminology is referring to, is a useful idea and we would therefore retain a section comparable to section 2.

F. Extending the Scope of the Act

We have so far discussed the definition of a security interest and the expository section, section 2, and recorded our general agreement with them. In so far as they cover security interests in the normally understood sense, agreement is not difficult since that is most clearly what the Act is about; in so far as they go beyond the traditionally understood meaning of "security interest" we have felt it right to say why we agree with the Model Act. There are, therefore, no major types of transaction included within the Model Act which we believe should not be included. The question we now turn to is whether there are transactions not included within the scope of the Act, but which ought to be included.

This question raises a general point about the underlying philosophy of the Act. At the most fundamental level, the Act is designed to regulate security interests in personal property as that concept is traditionally understood. But we have already seen that certain nonsecurity interests are included within the Act and we have expressed agreement with this inclusion. The decision to extend the scope of the Act beyond security interests in the strict sense reflects a realization that there is nothing sacrosanct about the notion of a security interest, as such, and suggests that the unifying theme of the Act is, in reality, more broadly based than simply the regulation of security interests.

But if the ambit of the Act is to extend beyond interests in the strict sense, how far is it to be extended, and what principle separates those transactions which ought to be included from those which ought not? It seems to us that one possible foundation for the Act is the existence of an interest in personal property unaccompanied by possession of the property.

This requires explanation. Not all personal property is capable of possession. We generally refer to such property as intangible and the Act itself incorporates this terminology. The obvious example is a debt, although there are many others, often largely within the realm of the specialist, such as the grant of a licence in respect of intellectual or industrial property (copyright, patent, and trademark). In the case of a debt, unless it is the subject of a negotiable instrument, the creditor can possess nothing, and it seems profitless to talk about the separation of possession and interest as the basis for saying anything about debts, or "accounts." But this is only superficially true. As between debtor and unsecured creditor, the creditor has no claim to any specific coins and notes, or any other property of the debtor. He therefore has no priority over a subsequent general creditor of the debtor, and since over-all thinking about the distribution of an insolvent∗s estate has not advanced to the point of preferring one general creditor to another (except in the case of certain protected classes), we need not be concerned with giving public notice of the existence of the creditor∗s claim against the debtor.

What the creditor owns, however, is a right of property, a chose in action. He may transfer it to an assignee if he wishes. It is at the point of such a transfer that the principle we believe ought to be the basis of the Act begins to operate. What the assignee receives is no longer simply a claim to money against the assignor. It is a right of property. It may depend for its value upon the debtor being able to pay it, but *vis-a-vis* the assignor, the assignee acquires a right which has the potential for defeating other assignees to whom the assignor may attempt to transfer an identical right. This fact differentiates the situation from that of the general creditor who, as we said above, has no right to any particular asset and who can enjoy no priority over other general creditors of the same debtor. The essence of the situation, like the case of a separation between possession and interest, is that the assignee claims a right against the assignor the existence of which is not readily observable. The separation of possession and interest may only apply analogically, but the analogy is none the less significant.

Turning to the other situations, the *Bills of Sale Act* requires registration of two types of documents: the conditional or security bill and the absolute bill. The latter does not express a security interest at all, but simply a purchaser∗s nonpossessory interest. There is much about the *Bills of Sale Act* that is unsatisfactory and should not find its way into new legislation; but the requirements that the buyer, outside the ordinary course of the seller∗s business, who leaves the seller in possession, should register his interest we believe to be sound in conception and illustrative of a policy which might also form part of a personal property security statute.

The Model Act itself creates a registration system designed to provide access to information about the existence of security interests. Although failure to register does not invalidate the security interest, an unregistered security interest is given such poor protection that it

will be defeated by most competing interests obtained in ignorance of its existence and, in many cases, even though its existence was known to the holder of the competing interest. But the registration system is only one aspect of obtaining a well-protected security interest. In the case of many types of collateral (those which are capable of being physically possessed, such as goods, documents of title, chattel paper, securities, instruments), the same or better protection, and in some cases the only protection, can be achieved by taking possession of the collateral.

Now if the secured party takes possession of the collateral, the separation between possession and interest ceases, and hence the need for registration disappears. The likelihood of people being deceived by the appearance of ownership in the party who granted the security interest has gone. In a sense, a new separation of possession and interest is created, because the party who granted the security interest still retains his "equity," but he is no longer in possession. At this stage, however, principle must bend to practicality. In the context of a financing transaction, where the secured party in possession is a professional lender, it is far more practical to require that people do not rely on the appearance of ownership than it is to require that the grantor of a possessory security interest give public notice of his interest.

We conclude, therefore, that one underlying philosophy of what should be included in the Act is that transactions resulting in a separation of possession and interest, such that others may be misled by the appearance of ownership, ought to be the subject of a notice system. This is a theme which commends itself on grounds of fairness and common sense but which must be applied with caution. The principle would have far-reaching consequences if applied without discrimination, and in many instances it will require mitigation in the light of competing considerations of convenience and fairness. Thus, if *A* lends to *B,* his neighbour, A∗s lawnmower, for the temporary and limited purpose for enabling *B* to mow his lawn, it would not be right to compel *A* to register his right of ownership against *B* in order to protect himself against *C*, a bona fide transferee for value from *B*. This is an example of a transaction where the inconvenience and formality that would be required to regulate such a casual, everyday, transaction is out of all proportion to the benefit that would be gained. Admittedly the case falls squarely within our principle of the separation of possession and ownership, but principle must in such a case give way to convenience and good sense.

In fact, there may be much in favour of the view that *C,* a bona fide transferee, should defeat *A,* the true owner, since *A* has voluntarily chosen to entrust his goods to *B* and has put *B* in a position to defraud *C*. But we think it right to say that, despite the successive incursions that have occurred in the last hundred years into the concept of security of title, attitudes among the public in general are not, or not yet, attuned to such a radical step.

The vast majority of situations in which there is a separation of possession and interest are the result of the granting of a security interest and occur in the context of wholesale or consumer financing. But there are some situations in which an arrangement has a financing function and results in a separation between possession and interest and yet it is not technically a secured transaction. Consignments and leases of property provide examples of a nonpossessory

interest in the consignor or lessor where the arrangement has or may have a financing function. Again, a bill of sale absolute involves a division of possession and interest, although it does not generally have a financing function.

The Act includes within the definition of security interest and within its scope of application any security interest in goods. Thus, if a consignor or lessor of goods in fact has a security interest, that interest falls within the ambit of the Act. On the other hand, if the rights of the lessor or consignor are not retained by way of security, the lease or consignment does not fall within the scope of the Act. With regard to a bill of sale absolute, the interest of the buyer not in possession is, *ex hypothesi,* not a security interest, and since there is no specific provision in the Act incorporating the transaction known as the bill of sale absolute, such transactions are outside the scope of the Act.

The effect of excluding bills of sale absolute from the Act, and at the same time repealing the *Bills of Sale Act,* would be that the rights of holder of a bill of sale absolute would be dealt with by the common law. The effect of registration under the *Bills of Sale Act* does not, at the present time, guarantee protection to the holder of the bill. It simply puts him in the position he would have been in at common law if there had been no requirement of registration. Thus, if a buyer of goods under a written contract of sale leaves his seller in possession of the goods and registers his interest as a bill of sale, the buyer will still be defeated under section 31 (1) of the *Sale of Goods Act* [9] by a subsequent transferee who takes possession of the goods in good faith and without notice of the previous transfer. Registration of the bill of sale is not notice to the subsequent transferee. The effect of repealing the *Bills of Sale Act* and excluding bills of sale absolute from the operation of the Act is to put the holder of a bill of sale absolute in the same position as that enjoyed under the present law by a holder of such a bill after registration.

The Commission, having concluded that one of the general principles which underlies the legislation, viz, a public notice system for transactions displaying a separation between possession and interest, feels that nonsecurity consignments and leases of goods and bills of sale absolute should all be included within the scope of the Act. In the case of leases, we believe that it is necessary to exempt certain transactions from the operation of the Act since the trouble and expense that registration would require would not be worth the advantage of a public notice system. Thus, the hiring of a car for a short period ought not to be regulated by the Act.

It is impossible to create a formula based on clear policy lines which separates, with certainty, the kind of lease that the Act ought to regulate from the kind of lease with which it should not be concerned. The kind of lease that we believe ought to be regulated by the Act is the long-term lease of industrial or commercial machinery and equipment. It is our view therefore, that the period of a lease ought to be one year or more in order for the transaction to fall within the terms of the Act. We also believe that, while the majority of leases of goods for a period in excess of a year are likely to be leases of equipment, there is no reason in principle why the Act should not also apply to leases of inventory or consumer goods for a year or more.

Article 9 is similar in terms to the Model Act with regard to the inclusion of leases and consignments: the transaction is only included in Article 9 if there is a "lease or consignment intended as security." In the United States a body of case law has grown up around the question of whether a lease or consignment is intended as security. The distinction is not always an easy one to draw and may involve difficult questions of degree. Apart from the functional similarity which may exist between security and nonsecurity leases and consignments, the avoidance of overly nice distinctions provides a further reason for including nonsecurity leases and consignments within the scope of the Act. We have come to conclude that the law is not assisted by these distinctions and that there is ample justification for the inclusion of so-called nonsecurity leases and consignments.

At the same time, we point out that where a lease of goods for a period of less than one year is granted, it will still be necessary to draw a distinction between security and non-security leases, the former but not the latter, being within the Act. It is unfortunate that we cannot completely abandon this distinction. One possibility might be to shorten the period required to bring a lease within the scope of the Act from one year to six months and then to exempt all leases for less than six months, including security leases. The theory behind this is that leases for less than six months are not likely to provide very good security, so the removal from the scope of the Act, of security interests carved out of such leases, is not likely to result in a rash of secret liens. Thus, the removal of leases for less than six months would be unlikely to cause a priority problem as between lessor on the one hand and execution creditor, trustee in bankruptcy, or secured party on the other. On the other hand, six months is quite long enough for the lessee to attempt a transfer of the leased goods to a bona fide purchaser for value. If the security lease is not registered, it may be difficult for that purchaser to discover the existence of the lessor. This point cannot, however, be pressed too far, because in any event non-security leases for less than six months would not require registration. In Ontario, nonsecurity leases for however long a period do not require registration, and yet the purchaser is equally vulnerable to the interest of the lessor in such a case.

Whatever solution is adopted, there are likely to be imperfections. The conclusion we have reached we think to be the best over-all compromise.

The Commission recommends:

1. The definition of "security interest" in section 1 (y) of the Act be modified so as to provide:

"security interest" means

(i) an interest in goods, documents of title, instruments, securities, chattel paper, or intangibles that secures payment or performance of an obligation;

(ii) the interest of an assignee under an assignment of an account or chattel paper, whether or not intended as security;

(iii) the interest of a buyer under a sale of goods which is not in the ordinary course of business of the seller if the seller remains in possession of the goods after the buyer has a right to possession thereof;

(iv) the interest of an owner of goods leased for a term of one year or more;

(v) the interest of an owner of goods delivered under a consignment.

2. *Section 2 of the Act be modified so as to provide:*

Subject to section 3, this Act applies to

(a) every transaction without regard to its form or to the person who owns the collateral that in substance creates or provides for a security interest, including a transaction that is or is evidenced by a chattel mortgage, conditional sale, equipment trust, floating charge, pledge, trust deed, or trust receipt;

(b) a lease of goods intended as security or created for a term of one year or more;

(c) an assignment of an account or chattel paper, whether or not intended as security;

(d) a sale of goods which is not in the ordinary course of business of the seller if the seller remains in possession of the goods after the buyer has a right to possession thereof;

(e) a consignment, whether or not intended as security.

As a consequence of making these recommendations, it would be desirable to include a definition of the term "lease" and to amend the definition of "debtor" in section 1 *(g)* of the Act. It is also our view that the definition of "consignment agreement" in section 1 *(dd)* could be improved slightly.

The Commission recommends:

1. *The addition to section 1 of the following definitions:*

(a) "consignment" means a transaction under which

(i) goods are delivered to a consignee for resale or lease by a consignor who in the ordinary course of his business deals in goods of a similar kind; and

(ii) the consignor retains title in the goods until he has been paid there for or until the goods have been resold or leased;

(b) "lease" means a transaction under which, for value, an owner of goods permits another person to have possession and use of the goods.

2. *The definition of "debtor" in section 1 (g) of the Act be modified so as to provide:*

"debtor" means a person who owes payment or other performance of the obligation secured whether or not he owns or has rights in the collateral, and includes

(i) the consignee under a consignment;

(ii) the lessee under a lease;

(iii) the assignor of an account or chattel paper; and

(iv) the assignee of a debtor∗s interest in collateral,

or such one or more of them as the context requires, and where a debtor is not the owner of the collateral, the term "debtor" means the owner of the collateral in any provision of the Act dealing with collateral and the obligor in any provision dealing with the obligation, and may include both where the context so requires.

G. Narrowing the Scope of the Act

Section 3 of the Model Act contains a list of situations and transactions which are exempted from the Act, even though the situations and transactions in question would be caught by the general definitions contained in the Act. Section 3 of the Uniform Act contains a similar list and section 3 of the Ontario Act contains the same provisions and adds other in addition. Section 9-104 of the Code also contains a list of excluded transactions which is much more extensive than those obtained in the Canadian drafts. The various provisions of the Model Act are set out *in extenso* in Appendix A. Here we discuss them *seriatim:*

1. SECURITY INTERESTS CREATED BY STATUTE

According to section 3 of the Model Act:

This Act does not apply

(a) to a lien given by statute or rule of law, except as provided in section 32, clause *(b)* of subsection 4 of section 36, and clause *(b)* of subsection 2 of section 37;

The Uniform and Ontario Acts contain similar provisions. Apart from these general provisions excluding liens given by statute or rule of law, there is also a specific provision in the Ontario and Uniform Acts relating to *The Sale of Goods Act.* Section 3 (2) of the Ontario Act provides:

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

Section 3 (2) of the Uniform Act provides:

The rights of buyers and sellers under *The Sale of Goods Act* are not affected by this Act.

Article 9 contains three provisions dealing with statutory and common law liens. According to section 9-104:

This Article does not apply

(a) to a security interest subject to any statute of the United States to the extent that such a statute governs the rights of parties to and third parties affected by transactions in particular types of property; or

(b) to a landlord∗s lien; or

(c) to a lien by statute or other rule of law for services or materials except as provided in Section 9-310 on priority of such liens;

The matter of the form in which exclusionary provisions should be drafted is not an easy one. Our general preferences are on the side of precision and completeness rather than blanket provisions which are apt to create uncertainty; in that we are no doubt not unique. The difficulty comes in applying that principle.

We find section 9-104 *(a)* of the Code to be a useful provision. It is no doubt covered by section 3 *(a)* of the Model Act, but we feel that a specific reference to statutes of the Parliament of Canada would be helpful and we are attracted by the format of section 9-104 *(a)*.

A general class of liens arising otherwise than by grant should not be subject to the Act. The class includes the so-called landlord∗s lien, repairers' possessory liens, and liens arising under the *Sale of Goods Act* or the *Mechanics' Lien Act.* The possibility of their existence is notorious. Although registration is necessary under the *Mechanics∗ Lien Act* due to the complexity of the situation and the many parties involved, it should not be necessary for the repairer∗s possessory lien, the landlord∗s lien or the rights *in rem* of a seller under the *Sale of Goods Act.*

The landlord∗s lien, or right of distress as it is generally known, is now restricted to commercial tenancies and is regulated by the *Distress Act,* although the right existed at common law. While it is probably included in the expression "lien given by statute or rule of law," we prefer to make separate mention of it in order to leave no doubt about the matter.

Section 3 *(a)* of the Model Act and section 3 (1) *(a)* of the Uniform and Ontario Acts both use the term "lien" to describe the general category of statutory and common law interests that are excluded. This appears to be taken from section 9-104 *(c)* of the Code, which also uses this term and is phrased in similar language. We would prefer to expand the scope of this exclusionary provision to bring within it charges and any other form of security interest created by statute or rule of law. In the United States the term "lien" may have acquired currency as a description of the genus of which a lien in the technical sense is itself a species. In Canada this usage is not perhaps as common.

2. OTHER EXEMPTED INTERESTS

In addition to the above exemptions, we have concluded that a number of other transactions should be excluded from the operation of the Act. It will be seen that several of them concern the assignment of debts in a situation in which there is no financing function; some concern internal corporate transactions; others involve matters which are regulated by other statutory provisions. The exemptions concerning the *Pawnbrokers Act* and insurance and annuities are also to be found in the Ontario Act, the Model Act, the Uniform Act, the Report of the Ontario Law Reform Commission, and the Catzman Committee Report. The others are not contained in any of the other Canadian Acts, although most, but not all, are contained in Article 9.

We have also considered the situation where a transfer of an interest in land is accompanied by a right to payment, such as a transfer by a lessor of his interest (including his right to

rent) or the transfer by a mortgagee of his interest (including the right to repayment of the sum advanced to the mortgagor). Real property interests are of course beyond the scope of the Act. But how should the transfer of the "account" which accompanied the transfer of the real property interest be treated? Our conclusion is that the interests of convenience, simplicity, and practicality are best served by excluding from the Act any transfer of a right to payment accompanying a transfer of an interest in land. It is also our view that the transfer of a right to payment that arises in connection with land such as rent due to a lessor, repayment due to a mortgagee, and payments due to a licensor should not come within the ambit of the Act, even though there is no accompanying transfer of any interest in land.

The Commission recommends:
Section 3 of the Act be modified so as to provide:
This Act does not apply to

(a) *a security interest governed by a statute of the Parliament of Canada to the extent that such statute provides for the rights of parties to the transaction creating or providing for the security interest and of third parties affected by the security interest;*

(b) *a lien, charge, or other security interest given by statute or a lien given by rule of law for the furnishing of goods, services, or materials, except as provided in section 32, paragraph (b) of section 36 (4) and paragraph (b) of section 37 (2),*

(c) *a right of distress;*

(d) *a transaction to which the* Pawnbrokers Act *applies;*

(e) *an assignment of wages, salary, or other compensation owing or to become owing to an employee;*

(f) *a sale of an account or chattel paper as one of the assets of a business being sold;*

(g) *an assignment of an account or chattel paper for the purpose of collection only;*

(h) *an assignment of a right to payment under a contract to an assignee who is to perform the assignor∗s obligations under the contract;*

(I) *an assignment of a single account to an assignee in whole or partial satisfaction of an existing obligation;*

(j) *an assignment between two or more shareholders of a corporation of an amount owing by the corporation to one or more of them,*

(k) *an assignment of an amount owing by a corporation included as part of a transaction for the sale by the creditor to the assignee of one or more shares of the corporation;*

(l) *a transfer of an interest in or claim in or under a contract of annuity or policy of insurance, except in so far as the moneys payable under a policy of insurance are or would be proceeds;*

(m) *a right of set-off;*

(n) the creation or transfer of an interest in or a lien on real property, including a lease, except to the extent that provision is made with respect to fixtures, and the transfer of any right to payment or rent that arises in connection with an interest in or lien on real property;

(o) a transfer in whole or in part of a claim to unliquidated damages;

(p) an assignment for the general benefit of creditors made pursuant to legislation of the Parliament of Canada relating to insolvency.

CHAPTER V THE CREATION OF A SECURITY INTEREST: ATTACHMENT

A. Introduction

In the previous chapter the scope of the Act and the definition of a security interest were considered, but only from the standpoint of a transaction which had already been entered into. The transaction was regarded as a *fait accompli* and we did not pause to ask at what stage in the process of entering into the transaction the security interest came into existence, what the minimum events essential to the birth of a security interest were, or what formalities must attend the enforceability of a security interest. To these questions we must now turn.

The question of how and when a security interest is created has significance for two main reasons. The "how" part of the question is important because, until the minimum steps necessary to create a security interest have been taken, a person advancing money cannot be more than an unsecured creditor. His very right to security depends upon those minimum steps being taken. Then "when" part of the question is important because the secured party's priority over a competing secured party who claims an interest in the same collateral may depend upon whose security interest came into existence first. It may, therefore, be of the utmost importance to establish the circumstances in which, and the moment at which, a security interest came into existence.

To discover how and when a security interest is created, it would have been perfectly possible for the framers of the Act to have contented themselves with the section which defines when the Act applies. In essence, according to section 2, the Act "applies to every security agreement that in substance creates a security interest;" and section 1 *(y)* (i) defines "security interest" as "an interest . . . that secures payment or performance of an obligation."

To find out how and when a security interest came into existence on the basis of these definitions, one would simply have had to ask whether the party claiming a security interest did in fact obtain an interest securing payment or performance of an obligation and, if so, at what time did he obtain it. No doubt some uncertainties would have arisen as to the manner in which and the time at which the security interest was born, but these could have been left to be worked out by the courts.

In fact, the framers of the Act chose not to leave these matters open. They felt that since the circumstances and time of creation of a security interest, obviously interdependent matters, were so important, it was worth while formalizing, within the Act itself, a basic rule of thumb to indicate how and when a security interest was created. Moreover, rather than refer simply to the manner and time of creation of a security interest, it was decided to give a name to the process of coming into being of the security interest. The name given was "attachment." The Act, therefore, sets out the circumstances in which a security interest can be said to exist, and at the moment when the conditions of existence are satisfied, the security interest is said to attach.

The relevant section of the Act is section 12 (1). It provides:

A security interest attaches when
(a) the parties intend it to attach;
(b) value is given; and
(c) the debtor has rights in the collateral.

A glance at these three requirements indicates that they are approximately the minimum conditions that would have to be satisfied before it makes sense to talk about a security interest. Paragraph *(a)* embodies the principle of freedom of contract: subject to complying with paragraphs *(b)* and *(c),* the parties may agree between themselves when the security interest is to attach. Paragraphs *(b)* and *(c)* embody the requirements that must be satisfied in order to give substance and content to the parties∗ intention to create a security interest. The secured party must have given value in order to support the debtor∗s obligation to him and the debtor must have acquired rights in the collateral in order to be able to grant them to the secured party.

B. The Role of the Concept of Attachment

The conditions that must be satisfied in order for a security interest to attach suggest very strongly that attachment is meant to represent the idea of creation of a security interest. Attachment is, therefore, something of a cornerstone in the conceptual framework of the Act. But nowhere in the Act is it stated that attachment means creation and no definition of attachment is to be found in the Act. This raises a number of questions in relation to the concept of attachment, not all of which are easy to resolve.

First, is the concept of attachment worth having in the Act at all? Would it not be simpler and more natural to rely on the Act's definition of a security interest to do the job which at the moment is assigned to attachment? If this approach were taken, whether a security interest had been created would depend solely on whether an interest had been granted that secured payment or performance of an obligation.

We have concluded that the concept of attachment should be retained. Our principal reason is that we would like our basic conceptual structure to be similar to that enacted in other jurisdictions in Canada and the United States, even though particular provisions may differ. Also,

we do not believe the concept of attachment does any harm and it may reduce the area of uncertainty in the context of some of the battles over priority.

Secondly, if attachment is to be retained as an operative concept in the Act, should it be defined? Should it be made clear that it does in fact mean creation of a security interest as every commentator on the Act says it does? As the Act is drafted at the moment, it seems that the creation of a security interest depends, technically, on satisfying the definition of a security interest, and that the significance of the concept of attachment relates only to priority between security interests in the same collateral.

In our view, definition is unnecessary. We would be reluctant to force the Act, if it were adopted in British Columbia, into what might seem to be a conceptual mould different from other North American versions unless it seemed important to do so. On this occasion we do not feel the point to be important enough to warrant departure from the other current versions of the Act. We are satisfied that attachment will be associated with the idea of creation of a security interest without the need for definition.

Thirdly, does it make any difference in substance whether the existence of a security interest is dependent only on satisfying the definition of a security interest in section 1 *(y),* or whether it must also satisfy the definition of attachment in section 12? It is difficult to conceive of something that secures payment or performance of an obligation and yet does not contain the elements needed to satisfy the definition of attachment. If, however, one could conceive of something sufficient to satisfy the definition of a security interest, but which did not satisfy the requirements of attachment, this would give birth to the concept of a security interest that had not yet attached. This question is discussed later in this chapter in the particular contexts in which it might arise.

C. Attachment and the Intention of the Parties

According to section 12 (1) *(a),* the parties must intend a security interest to attach in order for attachment to occur. The Act gives no guidance as to how this intention is to be discovered. In the simple case where the making of a security agreement and the giving of value are part of one transaction and the debtor already has rights in the collateral,[3] it will be easy to infer that the parties intended the security interest to attach at the same time as the events constituting the transaction took place. But it is too much to expect that in the very diverse circumstances in which security agreements are negotiated, the intention of the parties will always reveal itself with such ease.

When a provision such as section 12 (1) *(a)* refers only to party intention, and no assistance is given in ascertaining that intention, difficulties may arise. Two approaches are possible. The provision might be retained in its present form, and the problem of resolving uncertainty in particular cases left to the courts. Alternatively, a provision might be inserted to supply a *prima facie* guide to the intention of the parties which will be adequate for most cases and capable of re-

buttal in those cases where it proves inadequate.[4] In principle, the Commission prefers the latter technique. Its advantage is certainty. But it carries the danger that it may impose conditions on the parties which, if they had thought about the question, they would not have wished to impose.

Article 9 of the Code expresses a very clear preference in favour of certainty. After setting out the requirements of attachment (apart from the parties' intention), it then provides that attachment occurs as soon as those requirements are satisfied "unless explicit agreement postpones the time of attaching."

In our view the reconciliation of certainty with flexibility can best be achieved by a provision which takes the middle ground between the Model Act and the Code. The former gives no guide to party intention; the latter is absolutely determinative of party intention unless there is "explicit agreement" to the contrary. We favour a provision which gives prima facie indication of party intention, but one for rebuttal of which something less than explicit agreement will suffice.

The Commission recommends:

Section 12 of the Act be modified by deleting (a) and adding a proviso in the following terms: "Unless in all the circumstances it appears that the parties intended the security interest to attach at a later time, in which case the security interest attaches at the time the parties intended to attach."

D. The Giving of Value

Section 12 (1) also requires that the secured party must have given value before his security interest can attach. "Value" is defined in section 1 (z) as

> any consideration sufficient to support a simple contract, and includes an antecedent debt or liability.

The requirement that value be given, together with the broad definition of value, is closely allied to the definitional requirement of a security interest—that it must secure payment or performance of an obligation. The obligation in question may be one that is created at the time the security interest is granted, as where a loan is secured at the time it is made; or the obligation might start life as an unsecured loan, with the creditor being granted a security interest at a later time and hence becoming a secured party. In both cases the security interest secures payment or performance of an obligation—repayment of the loan. Equally, in both cases, value is given because value includes antecedent debts and liabilities. In other words the common law rule of contract that past consideration is no consideration applies neither to the definitional requirements for the existence of a security interest nor to the requirements of attachment of a security interest. In our view, this is undoubtedly the correct approach.

E. The Debtor∗s Rights in the Collateral

Section 12 (1) requires that, in order for attachment to occur, the debtor must have obtained rights in the collateral. This is nothing more than an expression of the common law maxim, *"Nemo dat quod non habet."* Clearly, in normal circumstances, a person cannot grant a security interest, or any interest, in things in which he himself has no rights. Two points suggest themselves.

First, do the exceptions which apply to the *nemo dat* rule apply also to the requirement that the debtor have the rights in the collateral, or does the peremptory language of section 12 (1) *(c)* preclude them? What if, for example, a principal holds out his agent as having authority to create a security interest when in fact the agent has no rights in the collateral? This type of problem is commonly encountered in any attempt to codify areas of law that have previously rested on a common law foundation. The common law is a network of interrelated groups of rules and principles. It is sometimes impossible to select one group of rules and imagine that it can be reduced to legislative form without seeming also to insulate that group from the application of general principles.

We are reasonably confident that an enlightened understanding of the relationship between legislation and general principles of common law would not lead to the inevitable suppression of the latter in favour of the literal supremacy of the former. The position could be taken that, since an area of general common law principle has been found which arguably ought to apply to the Act, provision should be made within the Act to guarantee its application. We would only accept this proposition with reluctance. The web of rules and principles that make up the common law is sufficiently complex and the application of the whole to particular cases is sufficiently subtle that no codifying measure could aspire to be self-contained. While the framers of legislation might foresee the relevance of a number of general principles and doctrines to the operation of the legislation, they would be deemed to fall short of perfection in many instances.

It is our belief that, in many instances, it must be left to the judges to determine whether, and to what extent, the general rules, principles, and doctrines of common law and equity remain current despite the incursion of legislation. We should give proper effect to the logical consequence of the role that the judicial process must fulfil by resisting the temptation to dabble in a species of problems, the genus of which only the judges can deal with in adequate fashion.

The second point in relation to the requirement that, in order for attachment to occur, the debtor must have rights in the collateral is ascertaining what is meant by "rights in the collateral." The everyday situation of a security interest granted over the debtor∗s inventory or equipment will not cause any difficulty; but there are likely to be many situations in which careful scrutiny of the phrase "rights in the collateral" will be needed.

When the collateral consists of goods, the problems are comparatively easy to grapple with. The law has arrived at a reasonably firm understanding of when property passes in

most kinds of situations and it is to be expected that the rules that have developed around the question of when property in goods passes will serve to indicate when a debtor obtains rights in goods/collateral. One point may be mentioned here in connection with conditional sale agreements and similar contracts. The purchaser under a conditional sale agreement does not obtain title until he has paid the contract price in full. In law, therefore, he has no rights in collateral until all the instalments due under the conditional sale agreement are paid. In equity, however, he is the owner as soon as the agreement to buy is made, since on general principle an agreement to buy vests equitable title in the purchaser. In the simple form of conditional sale agreement, therefore, no problem arises.

By contrast, however, in a contract for the hire of goods, whether or not coupled with an option to purchase, the hirer∗s only right is to possession and use of the goods, and he acquires neither legal nor equitable title. The problem is that, technically speaking, a hirer or lessee, having only a right to possession and use, may not obtain "rights in the collateral" for the purposes of the Act. Underlying this problem are some fundamental questions of law.

Can the rights of a hirer/lessee ever be of a proprietary nature? Can one draw a valid distinction between a lease of goods and a hire of goods, one creating something akin to a right of property in the goods and the other creating a contractual right only? If so, when does an agreement to grant possession of goods for a period of time amount to a lease and when does it fall short of a lease and hence amount only to an agreement to hire? Does the presence of an option to purchase in favour of the hirer guarantee the existence of "rights in the collateral?" These questions have no easy answers. The questions which have real property counterparts have proved baffling to the courts in that context, and we do not believe that a solution would be advanced by a nice analysis of the welter of authority. We recognize, however, a significant possibility that many hire and rental agreements in current use do not give the hirer "rights in the collateral," at least in any technical sense of the expression.

At the same time, it seems reasonably clear that the owner of the goods who hires them out may be a "secured party" within the meaning of the Act. Section 1 *(v)* provides that a secured party is a "person who has a security interest," and a security interest includes "an interest that secures payment or performance of an obligation."

Determining when an interest does in fact secure payment or performance of an obligation is not always easy, particularly in relation to transactions that fall outside the well-trodden paths of conditional sale and chattel mortgage. It would be difficult, however, to demonstrate that an owner∗s interest in goods which he hired out could *never* be an interest securing performance of an obligation. Neither could it be argued that, since all of the owner∗s legal and equitable rights remain intact, he enjoys, not merely a security interest, but full ownership. The policy running all through the Act is to disregard questions of title in the context of determining the existence and extent of a security interest. Moreover, to put the point beyond doubt, in our amended definition of "security interest" we have recommended that it should include "the interest of an owner of goods leased for a term or more than one year," and we have defined a lease as

"a transaction under which, for value, an owner of goods permits another person to have possession and use of the goods."

Given that a hirer might not obtain any legal or equitable rights in the goods he hires, and given that the interest of the owner in those goods is capable of being a security interest, the possibility exists that this might be a security interest which is incapable of attaching. The reason for this apparent anomaly may be an oversight or it may be the fact that there is a strong tendency to regard all contracts for the hire of goods as giving the hirer something akin to a right in the goods. The immediate cause of the problem lies in the drafting of the provisions concerning attachment. They are quite adequate for the case where the debtor acquires goods and then makes a grant of a security interest; they do not seem as well suited to the case where the secured party (who is also the owner) has reserved an interest in goods, possessory rights to which are given to the debtor.

Is the problem a serious one? Does it matter that there may be security interests within the meaning of the Act which are in their nature incapable of attaching? We believe it to be very serious indeed. As between secured party and debtor, it probably matters little. Generally speaking, the rights and remedies provided in the Act are also given to secured parties in the respective security agreements. Attachment is not a significant event. In the context of priorities, however, the fact of attachment is crucial. According to section 21 *(a),* a security interest cannot be perfected unless it has attached. If the security interest cannot attach, it is also incapable of perfection. This means that the secured party cannot protect himself against other secured parties, transferees, judgment creditors, and trustees in bankruptcy, even if he registers his security interest. Such a situation is indefensible.

Two solutions are possible. First, the Act could be left as it is in the hope either that the expression "rights in the collateral" would not be construed over-technically and would be held to include the possibly nonproprietory rights of a hirer, or that the judicial practice would emerge of treating all hiring agreements as creating rights in the subject-matter of the contract. Secondly, the Act could be modified to provide that the debtor∗s rights under a hiring arrangement were sufficient to permit attachment to take place. We favour modification of the Act in the direction of altering the requirements of attachment. The first alternative, involving no modification to the Act, seems fraught with danger and uncertainty; thus the second alternative seems preferable.

Section 12 (1) *(c),* which makes the debtor∗s having "rights in the collateral" a precondition of attachment, may also cause problems if the collateral is property other than goods. Consider the case of an account. According to section 1 *(aa):*

"account" means any monetary obligation not evidenced by chattel paper, an instrument, or securities;

In order for a security interest in an account to attach, the debtor must have acquired rights in the account. When does a person acquire rights in a monetary obligation?

For example, *D* forms the intention to write a book, intending to sell the copyright. He then enters into a contract to assign the copyright in the book on terms that he is to receive a lump-sum payment three months after the book is written plus a royalty payment measured by the number of copies sold.

Before the contract is entered into, *D* would seem not to have rights in a monetary obligation. But does he acquire such rights as soon as the contract is made, or when the book is written or three months after the book is written? And does *D* acquire rights in the royalty part of the monetary obligation when the contract is made, when the book is written, or from time to time as and when royalty payments become due? As an added complication, one must also bear in mind the fact that there is a residual category of collateral known as "intangible" and a right which fails to qualify as an account may still succeed as an intangible. According to section 1 *(m):*

"intangible" means all personal property including choses in action, that is not goods, chattel paper, documents of title, instruments or securities;[9]

The question facing our would-be author who wishes to obtain a loan on the security of the anticipated fruits of his book is: When can he be said to have acquired rights in a monetary obligation (an account) or in personal property other than a monetary obligation (a nonaccount intangible)? As in our previous discussion of goods, we are concerned here solely with the question of attachment, not with the question of the stage at which the debtor can grant an interest to secure repayment of a loan, the criterion for the existence of a security interest.

What amounts to the acquisition of rights in monetary obligations and personal property, for the purposes of the Model Act, seems very much an open question. Various approaches are possible. The courts might refer for guidance to the analogous question of when rights are assignable. While that does not seem to be a promising approach, it is an obvious one. Alternatively, they might decide that a new body of law has to be built up in order to determine when a debtor acquires rights in collateral for the purposes of the Act. They might also turn to American law on the point for guidance. If they did, they would find that Article 9 of the Code is more explicit on at least some of the problems concerning the meaning of "rights in the collateral" than the Model Act, particularly if the Official Comment is also taken into account. This might lead the courts to conclude either that it would be advisable to use the American version of the Act as an indication of what was probably intended or to conclude that, since the American version was worded differently, something different must have been intended.

The principle which we believe must be applied to resolve the difficulty caused by the concept of "rights in the collateral" is that there must not be situations where a security interest is held to exist but as to which there is no possibility of attachment. As in the case of goods/collateral, the requirements of attachment should be modified.

We have also considered the application of section 12 (1) *(c)* ("rights in the collateral") to the other possible types of collateral such as chattel paper, documents of title, instruments, and securities. As far as we are able to determine, they are unlikely to give rise to the problems that appear to exist in relation to goods, accounts, and intangibles.

Our answer to the problem of the debtor*s acquiring "rights in the collateral" is that the Act should not be drafted in such a way as to invite the conclusion that something akin to property rights, as opposed to mere contractural rights, must vest in the debtor before attachment can occur. It is not given to everyone to understand with any degree of precision where the line between proprietory rights and contractual rights is to be drawn. Conceptual categories do not exist for their own benefit, but rather to serve a purpose. What may look like a contract right for one purpose may seem closer to a property right for a different purpose; and the need for flexibility may cause the law to hover uneasily between several different lines of demarcation.

One solution might be to define collateral in such a way as to make clear that it means anything that may be subject of a security interest. At the moment it is defined as "property that is subject to a security interest." It would be helpful to add that "collateral," the thing in which the debtor has to have rights in order for attachment to occur, is a concept that includes anything that may be subject to a security interest. The requirements of attachment can then be guaranteed to avoid one of the problems of the unattachable security interest.

The Commission recommends:
The definition of "collateral" in section 1 (d) of the Act be modified so as to provide:

> *"Collateral" means property subject to a security interest and includes goods, accounts, instruments, intangibles, chattel paper, documents of title, and securities.*

This recommendation does not, however, solve the potential problem of goods that are hired out by the owners. The question here is not whether the thing in which the debtor has rights is "collateral," but whether the debtor has "rights" in collateral. Again, we believe the solution lies in indicating, reasonably clearly, that a right in collateral is not to be equated with a formalistic common law concept of proprietory rights.

We have given consideration to recommending that the section 12 (1) *(c)* requirement should be that the debtor acquire "rights in or to the collateral, whether proprietary or contractual." We do not wish, however, to suggest any rigid dichotomy between the two, nor to attempt to rest the conceptual structure of the Act on common law concepts which are, in many ways, unsatisfactory. The ideal provision would be one which avoids the suggestion of a reference to common law concepts of proprietary rights. We are inclined to think that the phrase "rights in or to the collateral" is adequate.

The Commission recommends:
Section 12 (1) (c) of the Act be modified so as to provide:

(1) A security interest attaches when

(c) the debtor has rights in or to the collateral.

Consolidating this recommendation with our earlier one relating to section 12 (1), the provision would now read:

A security interest attaches when

(a) value is given; and

(b) the debtor has rights in or to the collateral, unless in all the circumstances it appears that the parties intended the security interest to attach at a later time, in which case the security interest attaches at the time the parties intend it to attach.

CHAPTER VI THE CREATION OF A SECURITY INTEREST: ENFORCEABILITY AND EFFECTIVENESS

A. Introduction

The question of the enforceability of a security interest also arises as an incident of creation.

Section 10 of the Act provides:

A security interest is not enforceable against a third party unless

(a) the collateral is in the possession of the secured party; or

(b) the debtor has signed a security agreement that contains a description of the collateral sufficient to enable it to be identified.

This provision of the Act has been described as the Act∗s "Statute of Frauds." It sets out the formalities which are necessary to enforceability. Just as failure to comply with the actual *Statute of Frauds* does not render a contract void, but merely unenforceable, so the same results flow from section 10 of the Act in relation to security interests. Again, just as with a contract for the sale of an interest in land, a signed agreement or possession by the secured party is a condition precedent to enforceability. The analogy is obvious.

B. Against Whom Is the Security Interest Unenforceable?

According to section 10, if the required formalities are not complied with, the security interest in unenforceable "against a third party." Who is a third party? We believe it to be reasonably clear that a third party is anyone other than the debtor. We base this conclusion on the fact that both the 1962 Official Text of the Code [2] and the Report of the Catzman Committee provided that, unless the section 10 formalities were satisfied, the security interest would not be enforceable against either the debtor or third parties.[3] When the expression "third party" is juxtaposed alongside debtor in the context of the enforceability of a security interest, the conclusion seems inescapable that third parties are people other than the debtor and the secured party.

The Model Act, the Ontario Act, and the Uniform Act all dropped the reference to "debtor" in section 10. They provide only that there can be no enforcement against third parties without the compliance with formality. We agree with this basic position in preference to that of the Catzman Committee and the Code. The general problem which introduction of any requirement of formality poses is to balance the need to give effect to genuine, although informal transactions on the one hand, with, on the other hand, the desirability of assisting the judicial decision-making process by encouraging people to reduce their agreements to writing. The tendency in common law jurisdictions, which have, or have had, a Statute of Frauds, has been to find exceptions to the operation of the statute. This is perhaps inevitable. Ideas concerning the sanctity of contracts make it difficult for a judge to accept that a contract, the terms of which are established by irrefragable evidence, fails for want of a piece of paper. We believe there is value in recognizing this judicial reluctance to let noncompliance with formality act as a shield to contractual duty, and we would not, therefore, impose any requirement of formality *inter partes*.

Turning to the question of enforceability *vis-a-vis* third parties, the question is, perhaps, slightly different. We have considered the possibility of recommending the requirements of formality be done away with entirely, even as pre-conditions to enforceability against third parties. We do not believe this would result in a relaxation of standards on the part of financers in connection with formality. We are, however, prepared to follow the Model Act and the Uniform Act on this point. We therefore make no recommendation for modification of the principle contained in the Model Act that the requirements of formality should apply to enforceability against third parties, but should not extend to enforceability against the debtor.

We believe there may be room for improvement in the drafting of section 10. It is not as obvious what "third party" means when that expression stands alone, as it is when it appears in the composite phrase "debtor or third parties." Instead of saying "not enforceable against a third party," we would substitute "not enforceable against persons other than the debtor."

The Commission recommends:

Section 10 of the Act be modified by substituting for "third party" the words "persons other than the debtor."

C. Description of the Collateral

One of the ways by which a security agreement may be made enforceable against third parties is through the debtor having signed a security agreement containing "a description of the collateral sufficient to enable it to be identified." Similar words are used in the Uniform Act. The enforceability provisions of the Ontario Law Reform Commission Report, the Ontario Act, the Catzman Committee Report, and Article 9 require simply a signed security agreement that contains "a description of the collateral," no reference being made to identification. Despite this apparent isolation on the part of the Model and Uniform Acts, the two versions of Article 9 are in reality closer to them than to the Catzman Committee and the Ontario Report and Act. This is because according to section 9-110 of the Code:

For the purposes of this Article any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described.

Thus, there are three versions of the description necessary for the enforceability of the security agreement—"description of the collateral sufficient to enable it to be identified" (Model and Uniform Acts); description which "reasonably identifies what is described" (1962 and 1972 versions of Article 9); and "a description of the collateral" (Catzman Committee and Ontario Report and Act).

The point may seem trifling, but it is of major significance. Much commercial and wholesale financing is concerned with after-acquired property. In the nature of things, it is generally impossible to describe after-acquired property by item. It can only be described by type and, perhaps, by physical location. Since the very enforceability of the security interest *vis-a-vis* third parties, and hence the whole priority position of the secured party, depends upon the sufficiency of the description of the collateral, it will be seen that a degree of care is called for.

There are two situations to be considered. The first is where there is existing collateral in which the debtor has rights at the time security agreement is executed.[7] As to such collateral, it will sometimes be possible to give a precise description enabling each item to be identified, particularly if a serial number is appended to the collateral. On the other hand, in the "securityinterest-in-1000-widgets" situation, description by item will be difficult even for existing collateral. The second situation concerns after-acquired collateral, collateral in which the debtor has no rights at the time the security agreement is executed. Here description by item is always impossible, unless it is contemplated that the debtor acquire a particular item, which generally will not be the case.

A description requirement that contemplated, or even hinted at, identification by item, rather than by type, would be a serious inconvenience to obtaining financing facilities in many situations. The intention of the Act is to sweep away impediments which are the result of arbitrary and artificial requirements. We can see no reason why the usefulness of the Act should be impaired by difficulties of satisfying the requirements of description as long as people who deal with the debtor are able to discover what property is subject to a security interest and what is not. A requirement of description by type, together with a right to require the secured party to provide "a written approval or correction" of the individual items subject to the security interest at any given time, is quite adequate to permit such discovery. In addition, if description by type were recognized as sufficient, this would not have the effect of compelling the debtor to include all items of a given type in which he had rights, merely because he wished to grant a security interest in one of these items. Thus, if the debtor had 10 serial-numbered machines, he could grant a security interest in only one of them by inserting a description by item in his security agreement. Besides the description requirement for the enforceability of a security agreement, the various Acts and reports also require that the document by which a security interest is registered contain a description of the collateral. The kind of description required in this context by all the Canadian Acts and reports is one "sufficient to identify" the collateral. Article 9, however, requires "a

statement indicating the types, or describing the items of collateral." This we believe to be the best formula we have discovered.

The Commission recommends:

Section 10 (b) of the Act be modified so as to provide:

A security interest is not enforceable against persons other than the debtor unless

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(b) the debtor has signed a security agreement indicating the types, or describing the items, of collateral.

D. The Relationship Between Enforceability and Attachment

The requirements of attachment of a security interest (section 12) and the requirements for the enforceability of a security interest against third parties (section 10) are independent. Enforceability is possible without attachment and attachment without enforceability, at least theoretically. Pursuing this theoretical possibility, it means that a security interest might become "enforceable" against a third party, and presumably also against the debtor, before or after it had attached. In the discussion of attachment the twofold significance of that concept was noted. It is the nearest thing in the Act to a statement of the conditions required for creation of a security interest and it is also a significant event in measuring a secured party∗s priority against competing secured parties.

Is it realistic to talk of the possibility of enforcing a security interest before it has attached (i.e., comes into existence)? We think not. At the same time, there does lurk the possibility that such talk is not such obvious nonsense as it seems, and for this reason—the Act does not specifically say that attachment means creation of a security interest. There is always the possibility that facts might arise as to which one might have to conclude that an unattached security interest had come into being. This is unlikely, but if it did occur the consequences would not be important. We do not, therefore, recommend any modification to the Act to meet this possibility.

What of the possibility that a security interest might attach before it became enforceable? This can, and undoubtedly will, happen. The issue suggested by this possibility is this: A security interest might attach on January 1 (section 12 being satisfied on that date) and become enforceable against third parties on February 1 (section 10 being satisfied on that date). On January 10 a security interest in the same collateral might attach and become enforceable in favour of a competing secured party. Which secured party has priority? Now if either secured party has taken the additional step of "perfecting" his security interest, that party will have priority. Suppose, however, that both security interests remain unperfected. The Act provides that as between competing unperfected security interests in the same collateral, the order of attachment determines priority. In the example, one security interest attached on January 1, the other on January 10. It seems clear that January 1 security interest has priority. But that security interest did not

become enforceable against third parties (the January 10 interest) until February 1. Does this, or ought it to have any significance?

As the Act is presently drafted, it has no significance and the January 1 interest has priority. But ought a secured party whose security interest did not become enforceable until a date later than that of a competing secured party be able to obtain priority over his competitor?

In policy terms, we do not believe the question to be of great significance. The argument against allowing attachment prior to enforceability is this—the observance of formality is helpful in defining the *terms* of a security agreement and, in particular, what collateral is subject to a security interest; this is why formalities are required in order to enforce a security agreement against third parties. Similarly, if there is to be an argument about the priority of competing secured parties, the observance of formalities would help in identifying the *timing* of attachment, on which priority depends. The argument in favour of requiring that formalities be satisfied in respect of attachment is therefore the same as that in connection with enforceability.

The 1972 Official Text of Article 9 has adopted this approach. Section 203 makes attachment and enforceability mutually dependent. A security interest can neither attach nor be enforceable until the conditions required both for attachment and enforceability are satisfied.

In our view the point is not of sufficient importance to warrant recommending a change from the other Acts and reports that have been produced in Canada. The Commission therefore makes no recommendation on this matter.

E. The Effectiveness of a Security Agreement

Section 9 of the Act provides:

> Except as otherwise provided by this or any other Act, a security agreement is effective according to its terms between the parties to it and with respect to rights *in rem* created or provided for therein, third parties.

This provision is intended to encapsulate the notion of freedom of contract. It operates quite independently of the requirements of enforceability (section 10) and attachment (section 12). Care must be taken in construing the word "effective" as it appears in section 9. It does not mean effective in the sense that the security agreement can, without more, be the basis of claims against the debtor and third parties, since section 9 only applies "Except as otherwise provided by this . . . Act." Thus, for example, section 10 must still be complied with in order for the security interest to be enforceable against third parties. This implication of the word "effective" in section 9 is that the parties may agree on what terms and obligations they wish in their security agreement, and their right to create any obligations or interests they wish will be recognized. But whether their attempt to do so will be translated into actuality depends upon the various provi-

sions of the Act or any other Act which may have something to say about the matter. In other words, as long as the agreement the parties have made is a security agreement, their attempt to create a particular set of rights and interests will fail if a provision of the Act or another statute says it should, for one reason or another, fail.

In fact, the section does not seem of any great importance and its complete omission from the Act would probably not affect the construction put on the Act. It may, however, play a useful role in emphasizing that the concept of a security interest is not simply the aggregate of what can be achieved under the present law in the form of existing security devices.

If the section is to be retained, its drafting could be improved. In principle, it should be sufficient to say: "Subject to the provisions of this Act and, except as provided by this or any other Act, a security agreement is effective according to its terms." The whole of the rest of the Act is concerned with the question to what extent, and against whom, a security agreement is effective.[11] The remainder of section 9 is therefore unnecessary. The point is not, however, one of high importance and we make no recommendation beyond a slight alteration in the word order and phrasing of section 9.

The Commission recommends:

Section 9 of the Act be modified so as to provide:

Subject to the provisions of this Act, and except as provided in any other Act, a security agreement is effective according to its terms both between the parties to it and, with respect to rights in rem *created or provided for by it, against third parties.*

CHAPTER VII THE PRIORITY SYSTEM: THE BASIC PRINCIPLES

A. Introduction

The present law of personal property security is a patchwork of different species of security devices, with little or no specific machinery for accommodating situations in which conflicting security interests exist in the same collateral. This is not to say that there are no rules to determine which of two parties with a security interest has priority. There clearly are. But these rules are largely of ancient origin and were not developed in the context of an economy in which vast amounts of credit are granted daily in a multitude of different types of transactions. The existing rules of priority in the law of personal property have not been sufficiently well developed to keep abreast of commercial practice. Under the present law, certain types of security interests are precarious in nature. This is not because of any clear policy decision that the holder of a certain type of security interest should be more vulnerable than the holder of a different type of security interest, but because, for technical reasons, legal doctrine has failed to create the machinery for adequate accommodation of such security interests.

One of the principal objects of the Model Act is to ensure that the basis of determining priority between conflicting security interests shall be geared to a conscious and explicit recognition of policy considerations. The Act sets out, therefore, to provide rules for determining prior-

ity between all consensual conflicting security interests and, in some cases, between consensual security interests and other types of interest.

The Model Act contains a general rule for determining priority as between conflicting security interests in the same collateral, and, in addition, contains a number of special rules applicable to particular situations. If the coincidence of conflicting security interests falls within one of the special rules, the situation is taken out of the general rule and the special rule applies. If no special rule resolves the conflict, the general rule applies.

B. Attachment and Perfection

There are two fundamentally important concepts around which the structure of the priority rules is built. These are attachment and perfection. They are technical concepts and, although they are not explicitly defined, their significance appears from the various provisions of the Act. They correspond largely with the critical stages that occur in most secured transactions under the present law. Broadly speaking, the moment of attachment is the moment of birth of a security interest. We have already examined the provisions of the Act relating to attachment, in some detail, in Chapter V.

Once the conditions for attachment are satisfied, the secured party has a valid security interest. If the debtor defaults, the secured party may take advantage of the rights given to him under the Act to enforce his security. But his right is not at this stage a very potent one. It is true that he has already established a full complement of rights and remedies against the debtor and, no matter what additional steps he takes, he will not improve upon them. His concern, however, is not only with his position *vis-a-vis* the debtor, but also his position *vis-a-vis* third parties who may obtain an interest in the collateral. Against such third parties the measure of his priority is, at the stage of mere attachment, still relatively feeble.

Having caused his security interest to attach, the secured party is now anxious to protect himself against third parties in whose favour the debtor may try to create an interest in the collateral, and against third parties such as execution creditors and the debtor∗s trustee in bankruptcy who may obtain a nonconsensual interest in the collateral. It is here that the other basic concept, perfection, becomes relevant. The principle is that the secured party may obtain priority over many, but not all, conflicting interests in the same collateral by complying with the rules for perfecting his security interest. The general policy of the rules relating to perfection is to ensure that people, who might be led to conclude from the debtor's appearance of ownership that he has an unencumbered title to the collateral, are not misled. This is not a universal principle and there are some circumstances in which a security interest may be perfected, at least temporarily, even without any concession to the principle of notice. There are also circumstances in which the relevant principle is actual knowledge, rather than the giving of notice. These circumstances are rather particular and call for separate discussion. They will be mentioned briefly in the introductory survey which follows.

How then, generally, is perfection achieved? There are two ways. The secured party may take possession of the collateral, thereby removing the appearance of ownership in the debtor, or he may register his security interest, thereby enabling a third party to discover that the apparent owner∗s title is encumbered. Security interests in some types of collateral may be perfected either way; other types of collateral may require one method rather than the other. These matters are set out in sections 24 and 25 of the Model Act.

C. The General Rule of Priority: Section 35 (1)

Around these two key concepts, the attachment and perfection of the security interest, the general rule of priority between conflicting security interests in the same collateral is built. This general rule is set out in section 35 (1) of the Act which provides that, if there are two conflicting security interests in the same collateral, priority depends on the order of registration if both security interests have been registered. Thus, if an automobile dealer has raised two loans on the security of his inventory and both secured parties have registered their security interests, the one who did so first has priority over the other. The policy of this provision is straightforward. A secured party who wishes to maintain the highest degree of protection that the law will give to his security interest should give others the opportunity to discover the existence of that interest. Any party who subsequently contemplates taking security in the same collateral should be entitled to assume that, unless the official register records the previous security interest, he can proceed to perfect his own security interest without fear of being postponed to a person who had obtained a security interest at an earlier time, but failed to register it before the later secured party registers his security interest.

This provision applies only where both of the conflicting security interests have been perfected by registration. Security interests in some species of collateral can, however, be perfected under the Act by taking possession of the collateral as well as by registration and, in the case of certain collateral, a security interest can only be perfected in that way. If either one of two conflicting security interests has been perfected by a method other than registration, the general rule of first to register is inapplicable. In that case, the rule is that the first security interest to be perfected has priority.

Where neither or none of the conflicting security interests has been perfected, the third general rule applies and it provides that the order of priority of the conflicting security interests is the order of attachment.

Apart from these general rules of section 35 (1), there are a number of special rules which apply to particular kinds of security interest or security interests in particular kinds of collateral. Where one of the special rules applies, the case is taken out of the general rule. There are, in fact, many rather intricate rules designed to deal with particular transactions and problems, but in this introductory survey of the structure of the priority system, only the main features of these rules are considered.

D. Purchase-money Security Interests: Section 34 (2) and (3)

Certain types of security interests, called purchase-money security interests, are singled out from other forms of security interest and given especially favourable treatment. A purchase-money security interest is defined in the Act, and it refers to a security interest which secures payment of the purchase price or secures a loan given for and applied to the purchase of the collateral. The policy of this provision is that a secured party who has taken a security interest only to secure a debt which arises out of the secured party's having injected new assets into the debtor∗s total stock of assets should be given preferred treatment. A purchase-money security interest has priority over any other security interest in the same collateral, providing the secured party follows the procedures laid down in section 34 (2) and (3). These procedures are described in greater detail in Chapter XI.

E. After-acquired Property and Proceeds

Section 13 of the Act allows a secured party to register a security interest in property not yet acquired by his debtor. The security interest does not actually attach until the debtor obtains rights in the collateral, since one of the requirements of attachment is that the debtor obtain rights in the collateral. Nor can it be perfected, since one of the requirements of perfection is that attachment must have occurred. But once the debtor obtains rights in property of the kind described in the financing statement, the secured party∗s interest attaches immediately without the necessity of further formality and it is also perfected immediately, assuming it is the kind of collateral capable of perfection by registration.

In addition, the Act in several instances provides that a security interest in collateral may continue as to the proceeds of collateral. Proceeds are defined in the Act and include personal property in any form derived from any dealing with the collateral. The general provisions relating to proceeds are found in sections 27 (1) *(b)* and 27 (2). Section 27 (1) *(b)* simply states that, where collateral gives rise to proceeds, a security interest in the collateral extends to the proceeds. Section 27 (2) provides that if the security interest in the original collateral was perfected, the security interest in the proceeds is also perfected, but becomes unperfected after 10 days unless a financing statement covering the proceeds of the collateral has already been filed, or unless the security interest in the proceeds is perfected in some other way within the 10-day period.

The combined effect of the provisions relating to proceeds and after-acquired property, which has given rise to considerable controversy and a vast literature in the United States, will be considered in greater detail later in this Report.

In addition to the general proceeds section, there are also proceeds provisions which relate to particular types of security interest. Thus, the priority provisions in relation to purchase-money security interests also extend to the priority position of a secured party in respect of the proceeds of collateral in which he held a purchase-money security interest. There is

also a special priority rule dealing with security interests in crops and it, too, provides for the position of the secured party in relation to the proceeds of crops.

F. The Traders* Section: Section 30

Apart from the problem of conflicting security interests in the same collateral, there is also a problem of the conflict between a secured party and one who purports to purchase the collateral. Generally, and subject to the provisions of the Act and section 30 in particular, a security interest in collateral continues as to the collateral even though title to the collateral is transferred, unless the secured party expressly or impliedly authorized the disposition. This is provided for in section 27 (1).

Assuming, however, that, by virtue of section 27 (1), the security interest continues as to the collateral, the question then arises whether a person who acquires an interest in the collateral other than a security interest takes free of existing security interests, or takes subject to them. Here section 30 provides the answer, and it may vary according to the type of collateral in question. According to section 30 (1), a buyer or lessee of *goods* sold or leased in the ordinary course of business takes free of any security interest in the goods unless he knows of the security interest and knows that sale or lease is a breach of the security agreement. According to section 30 (2), sales in bulk, sales made to discharge pre-existing debts and sales as security for pre-existing debts cannot be sales in the ordinary course of business which enjoy this preferred position.

According to section 30 (3), a purchaser of chattel paper who takes possession of the chattel paper in the ordinary course of business may also take free of security interests in the chattel paper to the extent that he gives new value. If the security interest in the chattel paper exists by virtue of the section 27 security interest in the proceeds of collateral, and if the original collateral, of which the chattel paper represents proceeds, was inventory, the purchaser takes free of the security interest in any event. In the case of other types of security interest in chattel paper, the purchaser only takes free if he had no actual knowledge of the security interest at the time he took possession. Purchasers of non-negotiable instruments who take possession in the ordinary course of business are, under section 30 (4), in the same position with respect to security interests in the instruments. They are affected only by actual knowledge of the security interest.

G. Security Interests Under the Act and Interests Created Outside the Act

Most of the priority provisions of the Act are designed to deal with cases of two conflicting security interests in the same collateral. In many cases, however, the competition may be between a secured party whose priority is regulated by the Act and a person who claims the collateral by virtue of an interest other than one regulated by the Act. In this case the problem is one of co-ordinating two different systems of priority. The Act does not purport to be definitive about such difficulties, although it gives some general guidance.

Section 22 (1) *(a)* provides that "an unperfected security interest is subordinate to the interest of a person who is entitled to a priority under this or any other Act." Thus, perfection is an important step in protecting one∗s interests in personal property but also where a right created under that system comes into conflict with a right created under another system. Again, by section 22 (1) *(a),* "an unperfected security interest is subordinate to the interest of a person who assumes control of the collateral through legal process or who represents the creditors of the debtor as assignee for the benefit of creditors, trustee in bankruptcy or receiver."

Apart from execution creditors and trustees in bankruptcy, receivers, and assignees for the benefit of creditors, and priorities created under other Acts, there is also the problem of the transferee of the collateral. Certain transferees have already been mentioned in connection with section 30 (the traders∗ section), but other types of transferees must also be considered. If what the transferee obtains is actually a security interest, he remains within the personal property security system. If, however, the interest he obtains is not a security interest but full ownership, he is outside the security system of the Act and again the problem is one of accommodating two different systems of priority. Generally speaking, according to section 22 (1) *(b),* a buyer of personal property takes free of unperfected security interests in the property to the extent that he gives value in ignorance of the security interest.

H. Crops: Section 34 (1)

A rather special form of purchase-money security interest is created in crops under section 34 (1). The security interest in crops must, in order to come within the special rule, have been given "to enable the debtor to produce the crops during the production season and given not more than three months before the crops become growing crops." Here lies an analogy with the purchase-money security interest, although, unlike purchase-money security interests in other types of collateral, the consideration apparently need not, in fact, be used to produce crops. Of course, if no crops are in fact produced, there will be nothing to which the security interest can attach. Some crops must, therefore, be produced within the time limits envisaged by the subsection.

If the secured party satisfies these requirements, he obtains priority over a previously perfected security interest to the extent that the previous interest secures obligations that were contracted more than six months before the crops became growing crops. This is so, whether or not the later secured party knew of the earlier security interest. The policy of this provision is clearly to enable farmers to obtain finance at the crucial crop-growing season, and the relevance of the reference to six months appears to be to prevent the defeat of one financer of growing crops by another in the same season. The security interest in growing crops is thereby further strengthened.

I. Fixtures: Section 36

Fixtures are not defined in the Act other than by way of the exclusion of "building materials." The expression, therefore, has the same meaning as under the general law, the Act being concerned with regulating priorities rather than determining what are fixtures.

The problem of priorities as between persons interested in fixtures is another instance of the system of rights of security in personal property coming into contact with a different system of rights, in this case the real property system. The Act provides a more detailed resolution of the clash between the two systems in this instance than it does in the case of most other intersystem conflicts.

According to section 36 (2), "a security interest that attached to goods before they became fixtures has priority as to the goods over the claim of any person who has an interest in the real property." According to section 36 (3), if the security interest attached after the goods became fixtures, a person with a registered interest in the real property at the time of attachment has priority, unless he consents in writing to the security interest or disclaims his interest in the fixtures.

These two subsections are, however, made subject to another provision. According to section 36 (4), certain defined subsequent interests in the real property will take priority over a security interest that attached to goods before or after they became fixtures if the subsequent real property interest has no knowledge of the security interest and it is not perfected at the relevant time. The subsequent real property interests that may take free of the security interest in fixtures in these circumstances are ''a subsequent purchaser for value of an interest in the real property; a creditor with a subsequent lien on the real property obtained through legal process; or a creditor with a prior encumbrance of record on the real property in respect of subsequent advances."

Subsections (5) and (6) of section 36 set out the remedies of a secured party with priority over the real property interest in respect of fixtures. They provide for the right of the secured party to remove the collateral and the right of the real property interest to offer payment in lieu.

J. Accessions: Section 37

Accessions are defined in section 1 *(a)* of the Act to mean "goods that are installed in or affixed to other goods." Section 37 of the Act provides a set of priority rules to resolve conflicts between persons claiming a security interest in an accession and persons claiming an interest in the accession by virtue of its being installed or affixed to the principal goods in which they have an interest. The doctrine of accession is an analogue of the doctrine of fixtures in relation to real property. According to the principle of accession, when goods become annexed to or incorporated in other goods, the accession becomes part of the principal goods and the owner of the principal goods acquires the accession.

The rules laid down by section 37 for accessions are similar to those laid down for fixtures. Security interests that have attached to goods before they become accessions take priority over any interest in the principal goods. A security interest that attaches to goods after they be-

come an accession has priority over a subsequently acquired interest in the principal goods, but is defeated by an interest in the principal goods that existed at the time of attachment unless the principal goods interest has agreed to be subordinated. An unperfected security interest in the accession is, however, defeated by subsequent purchasers for value, lien creditors, and creditors with prior perfected security interests in the principal goods to the extent of subsequent advances, providing the purchase was made, or the lien obtained, or the subsequent advance was made without knowledge of the security interest.

Section 37 (3,) and (4) of the Act set out rights and remedies in relation to accessions. Subsection (3) allows the accession interest with priority to remove his accession on giving security for any damage caused by removal (although not counting simple diminution in value of the principal goods). Subsection (4) allows the principal goods interest to prevent removal if he is willing to pay the accession interest the amount as to which the latter has priority.

K. Commingled Goods: Section 38

Section 38 of the Act relates to the situation where goods/collateral lose their identity as a result of manufacture, processing, assembling, or commingling. A perfected security interest in such goods continues in the product or mass. If there is more than one such security interest, "the security interests rank equally according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total product or mass."

L. Subordination Agreements: Section 39

Section 39 of the Act provides:

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

This provision is self-explanatory and is useful in introducing a power of self-regulation to the parties. If a debtor is being financed by more than one secured party, rather than rely on the Act∗s priority rules in relation to general floating liens, the secured parties can, by agreement, create particular priorities for particular lots of collateral. We favour retention of this provision.

M. Returned or Repossessed Goods: Section 29

It may happen that goods which are collateral and have been sold by the debtor to a customer are later repossessed by the debtor or returned to the debtor by the customer. If the debtor has both inventory financing and receivables financing, there will be a problem of priority in respect of the returned or repossessed goods. The situation is not likely to arise frequently, but the Model Act provides for it in section 29.

The provisions of section 29 are to be found in Appendix A. Here we merely record the general principles. When goods are repossessed the inventory financer∗s security interest reattaches to them and a receivables financer, whether he is an accounts or a chattel paper financer, acquires a security interest in the goods. These interests must be perfected by the different secured parties, except that if the inventory financer had previously registered his interest and that registration is still effective, his interest is perfected by virtue of it. The order of priority between the various parties is, first, if the competition is between a chattel paper financer and an inventory financer, their respective priority as to the returned or repossessed goods is to be judged as if the goods had not been returned or repossessed, and the disputed item of collateral were still the chattel paper. This question is regulated by section 30 (3), which receives specific consideration in Chapter X; second, if the competition is between an accounts financer and an inventory financer who had previously perfected his security interest in the goods, the inventory financer has priority; third, if neither of these two rules supplies an answer (which they usually will), the general priority rules set out in section 35 apply—priority depends upon the order of registration or taking of possession of the collateral.

N. Conflict of Laws: Sections 5 to 8

The only reasonable thing that can be said about problems of the conflict of laws in a branch of law as complex as this is that one wishes they would go away. But, since they are hardly likely to be so compliant, the Model Act provides certain rules in sections 5 to 8:

The general principles of the Model Act are reasonably straightforward. In relation to intangibles, which includes accounts, and equipment and certain kinds of inventory that are normally used in more than one jurisdiction, the chief place of business of the debtor governs the creation and perfection of a security interest. If this is a province where the Act has not been adopted, then it is the old law, as applied in that province, which governs all aspects of the security interest. If, however, the debtor∗s chief place of business is in a province which has adopted the Act, then the Act governs all aspects of a security interest to which its terms apply. The one exception to this rule is that if the debtor∗s chief place of business is a province that has not adopted the Act, and under that province∗s law there is no provision for "perfecting" a security interest in intangibles or "mobile" goods, the security interest may be perfected by registration in the enacting province.

In relation to kinds of collateral which are not "mobile" goods or accounts, the general rule is that the law of the place where the goods are situated *(lex situs)* at the time the attempt to create a security interest is made governs the validity of that security interest *(locus regit actum)*. But, by way of exception, if at the time of creating the security interest the parties contemplated removal of the collateral into the enacting province and the collateral was so removed within 30 days, the law of the enacting province determines the validity of the security interest.

Where collateral (other than "mobile" goods or accounts) is perfected in one province and then brought into the enacting province, the secured party must perfect in the enacting province

within 60 days if his security interest is to retain its perfected status; but if the secured party receives notice that the collateral has been brought into the enacting province, he must perfect within 15 days of receiving notice in order to maintain his perfection. Whichever of these two events occurs first is the operative one.

We have considered these provisions and we have compared them with the latest American version on the subject. We believe the greater detail and complexity of the American provisions to be helpful, but we feel at this stage the best course lies in recommending adoption of the provisions of the Model Act. In the United States, virtually all jurisdictions have now adopted the Uniform Commercial Code. In the United States, therefore, the problem is no longer which law applies (since the basic provisions are the same in all states) but in which state secured registration is recorded. We in Canada are not likely to be in that position for some time, and in the meantime it seems to us better to opt for the more general provisions of the Model Act.

O. Conclusion

In this chapter we have given a general outline of the Act∗s priority system, with little or no comment on its substance. In the following chapters which relate to priority, specific aspects of the system are considered in greater detail. These relate to "problem" areas where we feel that a greater exposition is necessary for an understanding of the Act or where it is our view that the priority provisions of the Act should be modified. It may be taken that we agree with those provisions with respect to which no further comment is offered.

CHAPTER VIII THE PRIORITY SYSTEM: PERFECTION

A. Introduction

The Act∗s concept of "perfection" denotes the highest degree of priority which a security interest can attain. A perfected security interest is by no means impregnable, but it is as impregnable as the law will permit a consensual security interest to be.

From at least as early as *Twyne∗s Case,* decided in 1601, the common law established a rebuttable presumption that for a seller to retain possession of goods which he sold to a buyer was fraudulent and the transaction could be set aside at the instance of the seller∗s creditors.

In subsequent times, statute has intervened to require that certain interests may only be protected against certain classes of people if formalities are complied with. In general terms, the policy of the law was to require that a nonpossessory interest in personal property ought to be registered in a registry open to public inspection if that interest was to enjoy any prospect of immunity from attack by creditors and others who took a bona fide interest in the property.

On the other hand, the law was less concerned to intervene where a non-owner of personal property claimed an interest in that property, but he could back his claim by demonstrating that he had possession of the property. Thus, a pledge of personal property or a mortgage in which the mortgagee obtained possession of the property did not require to be registered to preserve it from attack by creditors of the pledgor or mortgagor. In such a case, there was not the same danger that the owner∗s possession of the property would create the appearance of ownership simply because the owner did not retain possession. Where a possessory interest was granted, the law did not, therefore, concern itself with requiring the mortgagee or pledgee to give public notice of his interest. His possession served the same purpose.

These simple and fundamental policies lie at the heart of the priority scheme embodied in the Act. They are doubtless worked out and carried through with much greater thoroughness and sophistication than under any previous law, whether common law or statute. But, subject to many special rules to deal with particular cases, the basic principle is that in order for a secured party to obtain immunity from attack by third parties such as creditors of the debtor, transferees, or competing secured parties, he must either take possession of the collateral or give public notice of his interest by registration. The process of obtaining maximum priority through registration or taking possession of collateral is called, by the Act, "perfection," and the outcome of the process is a "perfected security interest."

There are various different types of personal property. Some have a physical existence (such as goods), while others do not (such as a debt); some may have only documentary representation (such as negotiable instruments), while others may have both documentary representation and physical existence (such as goods covered by a document of title). The rules for perfecting a security interest must take into account the particular qualities of different types of personal property in deciding whether perfection may be achieved by registration, by taking possession of the collateral, or either way.

Besides the general rules for perfecting a security interest, there are certaln special rules in the Act applicable to particular situations. In some circumstances, for example, a security interest may be perfected for a limited period of time without registration or possession. Such perfection is generally called "temporary perfection." Again, there are special rules for the perfection of security interests in goods held by a bailee and in goods that were the subject of a perfected security interest until they were sold by the debtor, but that are then returned to the debtor or repossessed by him.

In this chapter we discuss all the various ways by which perfection may be achieved.

B. Time of Perfection

A security interest cannot be perfected until it has attached. Section 21 of the Act provides:

> A security interest is perfected when

(a) it has attached; and
(b) all steps required for perfection under any provisions of this Act have been completed,
regardless of the order of occurrence.

There is nothing to prevent a person who intends to obtain a security interest in collateral from registering prior to the time of attachment. If he does this, his security interest remains incapable of perfection until the security interest attaches, but his priority may still date from the time of registration rather than from the time of perfection. This is because, according to the general priority rules,[2] the date from which priority is measured is, in some circumstances,[3] the date of registration rather than the date of perfection. In such cases, the fact that perfection cannot occur until attachment is not, at least as between competing secured parties, very significant.

On the other hand, there are many instances where the crucial event in measuring priority is perfection rather than registration. This is because, despite the applicability of the general priority rules, the facts are such as to call for application of the first-to-perfect rule rather than the first-to-file rule; or because the collateral is of such a nature that perfection by registration is impossible;[6] or because, although the secured party chose to register rather than take possession of the collateral, he is able to rely on a period of temporary perfection prior to the time of registration.

The Commission agrees with section 21 and we see no reason to recommend any change in the drafting. The Catzman Committee Report, the Ontario Law Reform Commission Report, the Ontario Act, and the Uniform Act all contain provisions identical in terms to the one in the Model Act. Article 9 contains a provision[7] similar in meaning, but drafted rather differently. We prefer the various Canadian drafts.

C. Manner of Perfection: Possession of the Collateral and Registration

According to sections 24 and 25 of the Act:

24. Except as provided in section 26, possession of the collateral by the secured party, or on his behalf by a person other than the debtor or the debtor∗s agent, perfects a security interest in
(a) chattel paper;
(b) goods;
(c) instruments;
(d) securities;
(e) letters of credit and advices of credit; or
(f) negotiable documents of title;
but subject to section 23, only during its actual holding as collateral.
25. (1) Subject to section 21, registration perfects a security interest in
(a) chattel paper;
(b) goods;
(c) intangibles;
(d) any type of collateral the security interest in which arises under a floating charge.
(2) A security interest is not perfected until it is registered, except in the case of a security interest
(a) in collateral in possession of the secured party under section 24; or
(b) temporarily perfected in instruments, securities, or negotiable documents of title under section 26.

It will be seen that security interests in some types of collateral can only be perfected one way, whereas some can be perfected either by registration or possession. For the most part, the prescribed modes of perfection reproduce the methods which exist under the present law. The one extension of the present law occurs in connection with chattel paper. This species of collateral is defined in section 1 *(c)*. It provides:

"chattel paper" means one or more than one writing that evidences both a monetary obligation and a security interest in specific goods.[8]

Thus, a conditional sale or chattel mortgage of goods generates chattel paper. Under the present law, a transfer of this chattel paper would be treated as an assignment of an account plus a security interest, and its validity and priority measured accordingly. Mere possession of the chattel paper by the assignee would count for nothing in terms of priority. Under the Act∗s scheme of things, chattel paper is recognized as an independent type of collateral, which is something more than the two elements of which it is constituted. The ability to perfect a security interest in chattel paper by taking possession, in effect, creates a new species of quasi-negotiable instrument.

All the other Canadian drafts and Article 9 provide that a security interest in chattel paper should be perfectable by possession, and we are in agreement with this view.

D. Temporary Perfection

A number of provisions in the Act operate to create, or maintain, a perfected security interest even though there is no possession of the collateral or registration. Section 26 of the Act provides:

(1) A security interest in instruments, securities or negotiable documents of title is a perfected security interest for the first ten days after it attaches to the extent that it arises for new value given under a written security agreement.

(2) A perfected security interest in

(a) an instrument that a secured party delivers to the debtor for the purpose of

(i) ultimate sale or exchange,

(ii) presentation, collection or renewal, or

(iii) registration or transfer; or

(b) a negotiable document of title or goods held by a bailee that are not covered by a negotiable document of title, which document of title or goods the secured party makes available to the debtor for the purpose of

(i) ultimate sale or exchange,

(ii) loading, unloading, storing, shipping or trans-shipping, or

(iii) manufacturing, processing, packaging or otherwise dealing with goods in a manner preliminary to their sale or exchange,

remains perfected for the first ten days after the collateral comes under the control of the debtor.

(3) Beyond the period of ten days referred to in subsection (1) or (2), a security interest under this section becomes subject to the provisions of this Act for perfecting a security interest.

Subsection (1) has its genesis in the doctrine of the "equitable pledge." This device, which has no counterpart in Anglo-Canadian law, originated in the United States. It allowed a pledgee, who had failed in the first instance to take possession of the collateral at the time of entering into the pledge agreement, to relate the effectiveness of his pledge back to the

time of entering into the security agreement. The doctrine was only effective where the equitable pledge had been converted into a legal pledge by the pledgee∗s subsequent taking of possession. The equitable pledgee could, prior to taking possession, be defeated by bona fide purchasers and attaching creditors. It was, therefore, poor security. Its one point of impact came in the area of bankruptcy law. Until the American *Bankruptcy Act* was amended in 1938, there were circumstances in which an equitable pledgee who took possession prior to the time of filing of a bankruptcy petition could relate his pledge back to the time of the pledge agreement, thereby protecting it from vulnerability as a fraudulent preferrence.[9]

Subsection (1) is similar in effect to section 9-3 04 (4) of Article 9. This, in turn, was based on a provision of the American *Uniform Trust Receipts Act.* The provision was also adopted by the Catzman Committee, the Ontario Law Reform Committee, the Ontario Act, and the Uniform Act.

We are not convinced that this provision is necessary. It is true that the period of automatic perfection without either filing or taking possession is confined to 10 days, and this is not a substantial period for innocent parties to be misled by the appearance of unencumbered ownership. It is, however, a departure from principle and one that does create dangers. We have no evidence to justify its inclusion in a British Columbia Act and are not persuaded of its value.

The Commission recommends:
Subsection (1) of section 26 of the Act be omitted.

Subsection (2) of section 26 also has as its immediate progenitor the American *Uniform Trust Receipts Act,* although its more remote origin is probably the doctrine of release for a temporary and limited purpose in the law of pledge. A similar provision is to be found in all the Canadian drafts of the Act and in Article 9, although in the case of Article 9 there are differences of drafting and of substance. The Canadian drafts do not include securities within the scope of section 26 (2), whereas Article 9, in theory at least, does. On this point we prefer the Canadian version.

The policy underlying section 26 (2) *(b)* is that in many transactions a secured party who has perfected his security interest by taking possession of the collateral will wish to release possession to the debtor for a particular short-term purpose. To require registration in such cases would impose an excessive and unwarranted burden on the parties and on the registry. The situations to which section 26 (2) will most readily apply are those corresponding to the classic trust receipt situation. They generally concern documentary sales of goods in which the financer receives possession of the bill of lading direct from the seller. The purposes for which temporary release of the collateral does not impede the perfected status of the
security interest are elaborated in section 26 (2).

The Commission agrees with this provision. It is not to be expected that the device will have much application outside the particular sphere for which it is intended, and when confined to that sphere it is a relatively safe device based on generally accepted commercial practice.

Subsection (3) of section 26 has the auxiliary function of confirming that once the 10-day grace period given by subsections (1) and (2) has expired, possession of the collateral or registration becomes necessary to achieve (subsection (1)) or maintain (subsection (2)) perfection. The provision should be retained for the purposes of subsection (2).

Another instance of temporary perfection being granted under the Act without the need for possession of the collateral or registration arises in the context of "proceeds." According to the definition section of the Act, proceeds are "personal property . . . derived . . . from any dealing with collateral. . . ." Section 27 (1) provides that a security interest in collateral "extends to the proceeds" and section 27 (2) provides that a security interest in proceeds is perfected for 10 days providing the security interest in the original collateral was perfected. It will be seen that section 27 not only grants automatic temporary perfection of a security interest, it also creates that security interest.

The proceeds provisions of Article 9 have given rise to much controversy in the United States. The focus of attention has been the effect of the proceeds provisions on the operation of the priority rules. This matter is discussed in the context of the priority rules later in this Report. Here, we simply draw attention to its existence as an instance of automatic temporary perfection, and add that we agree that the Act should contain some such provision relating to proceeds.

Two other provisions are worth noting in the context of temporary perfection, although detailed discussion is again postponed. Both relate to purchase-money security interests. According to the definition section:

"purchase-money security interest" means a security interest that is
(i) taken or reserved by the seller of the collateral to secure payment of all or part of its price, or
(ii) taken by a person who gives value for the purpose of enabling the debtor to acquire rights in the collateral, if such value is applied to acquire such rights.

It will be seen that the essence of the purchase-money interest is that it is granted to secure credit or a loan which results in thhe debtor acquiring new collateral.

According to section 22 (2), "a purchase-money security interest that is registered before or within 10 days after the debtor∗s possession of the collateral commences has priority over . . ." various other interests. According to section 34 (3):

A purchase-money security interest in collateral or its proceeds, other than inventory, has priority over any other security interest in the same collateral if the purchase-money security interest was perfected at the time the debtor obtained possession of the collateral or within ten days thereafter.

These two provisions do not grant temporary perfection in quite the same way as those relating to trust receipt devices and proceeds. The former perfects a security interest only

if it is ultimately registered. If it is never registered, or not registered within the 10-day grace period, the provisions do not apply. Sections 26 and 27 operate regardless of whether the security interest is ever perfected by act of the parties. Again, strictly speaking, sections 22 (2) and 34 (3) are not perfection rules at all, but are actually priority rules. They determine directly what the purchase-money secured party's priority is against certain competing claimants, whereas the true temporary perfection provisions of sections 26 and 27 merely determine one of the ingredients in priority—the date of perfection. We mention them in this context since they provide periods of grace during which the absence of perfection is innocuous to the secured party in circumstances where, but for these special provisions, it might prove fatal.

The Commission agrees that such provisions are desirable for purchase-money security interests, although discussion of their priority implication is postponed. The policy on which such provisions rest is that the secured party who receives a purchase-money security interest ought to receive a special priority advantage since he has supplied new value to the debtor∗s assets. This, in itself, does not justify the 10-day grace period, merely the special priority position. Further discussion of this matter is also postponed.

E. Goods Held by a Bailee

Where goods are held by a bailee, the problems of perfection and priority are rather special. Frequently the bailee will issue a document of title in relation to those goods. The problem is to determine which is the operative piece of collateral for the purposes of creating and perfecting a security interest, the goods or the document of title. The Act divides documents of title into two categories: negotiable and non-negotiable documents of title. Where a negotiable document of title has been issued, the document is everything. Section 28 (1) provides:

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

If no document of title, or a non-negotiable document of title, has been issued in relation to goods held by a bailee, various methods of perfection are permissible. Section 28 (2) provides:

> A security interest in goods in the possession of a bailee, other than a bailee mentioned in subsection (1), is perfected by
> *(a)* issuance of a document of title in the name of the secured party;
> *(b)* a holding on behalf of the secured party pursuant to section 24; or
> *(c)* registration as to the goods.

The method of perfection provided in paragraph *(b)* reflects the common law notion of attornment. This has been abandoned in Article 9, according to which receipt by the bailee or notification of the existence of the security interest is sufficient for perfection. The Commission has considered the question whether the time has not come to abandon the common law notion of attornment and adopt the American position. We have decided to follow the lead of the other

Canadian drafts and retain the requirement of attornment and recommend no change in this aspect of section 28.

Section 22 of the *Warehouse Receipts Act* provides:

(1) A person to whom a non-negotiable receipt is transferred acquires, as against the transferor,
(a) the title to the goods; and
(b) the right to deposit with the warehouseman the transfer or a duplicate thereof.
(2) Upon deposit under clause *(b)* of subsection (1), the transferee acquires the benefit of the obligation of the warehouseman to hold possession of the goods for him according to the terms of the receipt.
(3) Prior to deposit under clause *(b)* of subsection (1), the title of the transferee to the goods and the right to acquire the benefit of the obligation of the warehouseman may be defeated by the deposit with the warehouseman by another person of another transfer from the transferor.

This raises an additional way in which a secured party may perfect an interest in goods held by a bailee: the deposit of a transfer of a non-negotiable receipt with the bailee pursuant to section 22 (2). We think this possibility should be reflected in the Model Act by an addition to section 28 (2).

The Commission recommends:
A new section 28 (2) (d) be added in the following terms:
"(d) deposit, by a secured party to whom a non-negotiable receipt has been transferred, of the transfer with the warehouseman who issued the receipt, in accordance with section 22 (2) of the Warehouse Receipts Act."

CHAPTER IX THE PRIORITY SYSTEM: ORIGINAL COLLATERAL, PROCEEDS, AND AFTER-ACQUIRED PROPERTY

A. Introduction

It has been pointed out that the basic aim of the Act is to simplify and facilitate the creation of security interests. The Act allows a perfected security interest to be created, by a single security agreement and a single act of filing, in presently owned property, after-acquired property, and proceeds.

One consequence of introducing this degree of simplicity into the process of creating a security interest was the realization of the ease with which two or more conflicting security interests might be created in the same collateral, thus giving rise to a problem of priority. Of course, priority problems in the field of secured transactions are not a new phenomenon, but as long as the various separate devices for creating a security interest exist side by side, they tend not to be as obvious. The main concern is to select a suitable security device and to ensure that everything necessary to its enforceability is carried out. When the different security devices are all cast in a single mould, the possibility of conflicting security interests is more easily perceived. Moreover, the easier it is for security interests to be created, and the more types of collateral they are permitted to embrace, the greater the likelihood that there will be conflicts between two or more secured parties. In this sense, the Act may contribute to the possibility of there being con-

flicting security interests in the same collateral and may add to the need for a thorough-going system for determining priority.

The framers of Article 9 saw very clearly that there was a need to provide a method of resolving priorities between conflicting security interests in the same collateral and they created a rather complex set of rules for this purpose. Many of these rules have been incorporated into the Act, sometimes in the same form in which they appeared in the 1962 text of Article 9, sometimes in a modified form. This and the following chapters of this Report attempt to analyse these rules and to make recommendations concerning the extent to which they should be modified before being incorporated into the law of this Province.

The priority rules contained in the Act are of two types. They may be conveniently termed "special priority rules" and "general priority rules" and the security interests to which they apply may be termed "special security interests" and " general security interests" respectively.

The relationship between the two sets of priority rules is straightforward. Certain types of defined security interest are singled out for special treatment in the Act and are given priority over other types of security interest. If a special type of security interest is found to exist, and it has been perfected, the answer to any priority problem involving that special type of security interest will generally be determined, without more, by the special priority rule applicable to that type of security interest. If neither of two conflicting security interests is regulated by a special priority rule, the general priority rules will apply to resolve the conflict. Application of the general priority rules will involve references to the time at which certain acts were done. The application of a special priority rule, however, requires only that the security interest be correctly identified as being of a special type, and its priority as against conflicting security interests will then generally be determined without reference to factors such as the time of attachment or perfection.

There is no doubt that the priority rules of Article 9 of the Act are, from a purely technical point of view, the most difficult feature of the security scheme. In the United States, the priority rules, particularly the general rules, have given rise to a vast literature, with eminent authorities on the subject frequently expressing differing views as to what was intended. It appears to the Commission that the same difficulties and ambiguities that have been discovered in the 1962 Official Text of Article 9 are also largely to be found in the Model Act. It is therefore our view that, despite the extreme difficulty and obscurity of many of these problems, it is incumbent upon us to explore them before we are in a position to make recommendations with regard to the law of this Province. The 1972 Official Text has sought to resolve the ambiguities in the priority rules with regard to Article 9. We also examine this attempt at solution.

In this chapter we discuss the general priority rules. The various provisions of the Act which are important to the operation of those general rules are first outlined; their general structure is then analysed with a view to discovering any defects or ambiguities; next follows a dis-

cussion of specific examples of the working of the general priority rules in cases in which difficulty has been encountered in the United States; next, the amendments to Article 9 contained in the 1972 Official Text are examined; and finally, we record our conclusions and recommendations.

B. After-acquired Property

Section 13 (1) of the Act provides:

Except as provided in subsection (2), a security agreement may cover after-acquired property.

The aim of this provision is to allow the secured party to incorporate into his security interest items of collateral in which the debtor has not acquired rights at the time the security interest is created. The secured party will not obtain any interest in such collateral until the debtor acquires rights therein, since, until that time, the debtor has nothing to grant to the secured party. This basic point seems to be reflected in the conditions set out in section 12 (1) for the attachment of a security interest. Clause *(c)* provides that attachment cannot occur until the debtor has rights in, or to,[2] the collateral. Once the debtor acquires rights in property described in the security agreement, assuming the other conditions of attachment to be satisfied, the secured party∗s security interest will then attach as to the "now-acquired" collateral.

The facility for providing for a security interest in after-acquired property is likely to be most important in those situations where it is contemplated that the particular items of original collateral will disappear in the course of time and be replaced by other items of the same type. Thus, it is obvious that a security interest in particular items of inventory is not, on its own, likely to be a very valuable right for any extended period. In the course of time the debtor hopes to sell his inventory and replace it by new stock. It is to be expected, therefore, that an inventory financer will often want his security interest to cover the new stock. Section 13 (1) confirms[4] the ability of the secured party and the debtor to provide that it shall do so.

Similarly, a person advancing funds on the security of an interest in chattel paper, or intangibles such as accounts, will frequently require that his security interest cover after-acquired property since such collateral is also wont to disappear in the course of time and be replaced by new collateral of the same type.

The ability to provide for a security interest in after-acquired property is basic to the idea of creating a continuing general lien. In the United States, this was a major break with previous legal tradition. In fact, secured parties had been creating what in practice amounted to a continuing general lien prior to the adoption of Article 9, but, in order to do so, they were forced to resort to extensive policing of the debtor∗s activities in one form or another. Legal theory had not caught up with the actual practice of secured financing. As far as the United States is concerned, the notion of a continuing general lien is simply the granting of legal blessing to existing practice.

In Canada the situation is rather different. The notion of a floating charge, invented and developed by the English Chancery Judges in the latter half of the 19th century and the early years of the 20th, has long been a common feature of Canadian company law. It permits the granting of a security interest in after-acquired property, leaving the company free to deal with existing collateral in the ordinary course of business in much the same way as Article 9 and the Act does. In legal conception, the provision of a security interest in after-acquired property, of the notion of continuing general lien, marks no great break with the past.

Section 13 (2) *(b)* of the Act limits the ability of a secured party to acquire a security interest in after-acquired consumer goods. Section 13 (2) *(b)* provides:

> No security interest attaches under an after-acquired property clause in a security agreement
> *(b)* to consumer goods, other than accessions, unless the debtor acquires rights in them within ten days after the secured party gives value.

This provision is a limitation on the general freedom of contract provided for in section 9. Its character is that of consumer protection legislation and as such is given more detailed consideration in a later chapter of this Report which is devoted to a broader discussion of related issues. We raise it here only for the sake of completeness.

C. Proceeds

Section 27 of the Act provides:

> (1) Subject to this Act, where collateral is dealt with or otherwise gives rise to proceeds, the security interest therein
> *(a)* continues as to the collateral, unless the secured party expressly or impliedly authorized such dealings; and
> *(b)* extends to the proceeds.
> (2) The security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected but it ceases to be a perfected security interest and becomes unperfected ten days after receipt of the proceeds by the debtor unless
> *(a)* a registered financing statement covers the original collateral and proceeds therefrom; or
> *(b)* the security interest in the proceeds is otherwise perfected before the expiration of the ten day period,
> but there is no perfected security interest in proceeds that are not identifiable or traceable.

Proceeds are a species of after-acquired property. They differ from general after-acquired property in that they are only that part of the debtor's after-acquired property which he acquires in exchange for other property which was, itself, the subject of a security interest.

The expression "proceeds," unlike the expression "after-acquired property," is given a formal definition in the Act. Section 1 *(r)* provides:

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

The effect of the proceeds section (section 27) is that a person with only a security interest in "inventory" acquires, by operation of law, a security interest which extends to any accounts, chattel paper, or other proceeds that that inventory produces. If the security interest in the original collateral, or in now-acquired collateral, was perfected, the security interest as it pertains to proceeds is also perfected for the first 10 days after the debtor receives those proceeds . Thereafter it ceases to be perfected unless the secured party perfects [7] it by a method appropriate to the form of collateral constituting the proceeds. The security interest in proceeds which is perfected by operation of law is conveniently described as an "automatically perfected security interest."

Like many provisions of the Act, section 27 has two kinds of implication, firstly as to the permissible range of collateral that a security interest may embrace and secondly as to priorities. It is convenient to deal with the former of these here and postpone discussion of the latter.

The Act's definition of proceeds is, in substance, the same as that contained in the Uniform Act, the Ontario Act, and the Report of the Ontario Law Reform Commission. The Catzman Committee Report omits any reference to indemnity or compensation in respect of loss or damage.
The Article 9 definition of proceeds is structured rather differently. According to the 1972 version:[8]

"Proceeds" includes whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds. Insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement. Money, checks, deposit accounts, and the like are "cash proceeds." All other proceeds are "non-cash proceeds."

The first sentence of this definition is the equivalent of the Act∗s concept of personal property "derived . . . from any dealing with collateral." The Act∗s concept of "dealing" is not defined, although it would seem that the intention was to find a fairly abstract term covering a broad range of situations.

Thus, where a secured party has a security interest in goods which are in the debtor∗s possession, anything the debtor receives as a result of selling, pledging, mortgaging, leasing, hiring out, or exchanging the goods is probably rightly regarded as "derived . . . from . . . dealing with the collateral."

If the collateral in question is an account or chattel paper, the situation is less clear. It may be that a "dealing" with the account implies a transfer, rather than a liquidation, of the account. Hence, on the present wording of the Model Act's definition of proceeds, sums paid by the account debtor to the security interest debtor in discharge of the account may not be proceeds of a secured party∗s interest in the account. In principle we believe such payments should be regarded as proceeds and fall within the ambit of the security interest in the account. No doubt problems of tracing and identification arise as soon as the attempt is made to confront a security

interest in money. These difficulties do not, however, justify a retreat from what appears to be the correct solution.

Technically speaking, the definition of proceeds given in section 1 *(r)* of the Act is only concerned with the meaning of that expression as it relates to the operation of the section 27 provisions on automatic attachment and perfection of a security interest in proceeds. There is nothing to prevent a secured party from deciding for himself what he would like to be included in the security interest and obtaining the agreement of the debtor. The secured party may therefore construct his own definition of proceeds and register accordingly. Furthermore, even if the secured party registers a security interest in "proceeds," there is nothing to say that he is to be taken as using the word "proceeds" in the same sense in which the Act uses it. In practice, it seems that such possibilities are likely to remain hypothetical only. The most probable result of a registration covering "proceeds" is that the secured party will be taken to intend what the Act defines as proceeds. We think therefore that the definition of proceeds is likely to prove important not only in the case of automatic perfection under section 27, but in any case where a secured party registers as to "proceeds."

If the general policy of a security interest in things that replace collateral is accepted, we see no reason why this should not include payments made in discharge of an account or chattel paper. In our view the omission of such payments is inconsistent with the general policy of the proceeds provision and we believe it may lead to anomalies. Consider the case of an inventory financer and a receivables financer, both having security interests in a single debtor∗s inventory and accounts receivable. When the debtor sells an item of inventory, say on conditional sale, the account that comes into being will be original collateral *vis-a-vis* the receivables financer and proceeds *vis-a-vis* the inventory financer. But consider the position of payments made from time to time by the conditional buyer. They may not be "derived from dealing" with the account, but they might more reasonably be said to be "derived from dealing" with the inventory. The result may, therefore, be that the inventory financer, but not the receivables financer, has a proceeds interest in the money received by the security interest debtor in discharge of the account. This would be an undesirable result. Accordingly, we favour altering the definition of proceeds to ensure that moneys paid in discharge of an account would be treated as proceeds. The argument applies equally to chattel paper and instruments.

The Commission recommends:

The definition of proceeds in section 1 (r) of the Act be modified so as to specifically include money paid in total or partial discharge of an intangible, chattel paper, or an instrument.

The Model Act definition of proceeds includes "any payment representing indemnity or compensation for loss or damage to the collateral." Article 9, on the other hand, provides that "insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement." There is no mention in Article 9 of "compensation for loss or damage." It would seem from this that, according to the Act, if a financer has a security interest in goods which are damaged or destroyed in such a way

as to involve liability on someone∗s part, the secured party may claim as proceeds any damages recovered from the person found liable. By contrast, no such result appears to follow under Article 9. We believe that a secured party∗s interest ought, in general, to continue against any property which replaces the collateral, and this principle would include treating damages as proceeds.

We are not entirely sure why the Model Act uses the expression "indemnity or compensation for loss or damage to the collateral." It is probably intended to include both payments in the form of damages and insurance moneys. Neither "indemnity" nor "compensation" seems to be a well-chosen word, although they are perhaps sufficient to do the job. We see no reason why the words "damages" and "insurance moneys" should not appear expressly in the provision. "Indemnity" suffers from the defect that it has two, or perhaps three, meanings at common law and in equity, none of which is appropriate to the context of proceeds. In equity it usually refers to a sum payable on rescission of a contract for innocent misrepresentation and at common law it is used to denote a liability arising by virtue of someone else∗s liability, either in the "guarantee" situation or in the "string" contract situation. The problem with "compensation" is that, although in general terms it expresses the policy of the law in awarding damages, it does not ordinarily carry the connotation of the damages themselves. There is no better way of referring to damages than referring to "damages."

Despite wishing to see the addition of express references to insurance moneys and damages, we are not opposed to including indemnity and compensation as well. They may carry shades of meaning which insurance moneys and damages, on a strict construction, do not. Thus, the equitable indemnity available on innocent misrepresentation is sometimes contrasted with damages and said not to be damages; and statutory compensation may not ordinarily be looked on as damages. Both of these are a little fanciful in the security interest situation, but since the expressions "indemnity" and "compensation" do no harm, we do not recommend their omission. We would also add that payments received as a result of settlements and that "rights to payment" as well as "payments" should be included within the definition of proceeds.

The Commission recommends:

The definition of proceeds in section 1 (r) of the Act be modified so as to provide that proceeds "includes any payment received by way of damages, insurance, compensation, indemnity, or settlement in respect of loss of or damage to the collateral or proceeds therefrom, or any right to such payment."

It will be noticed that the Article 9 provision on proceeds includes insurance "except to the extent that it is payable to a person other than a party to the security agreement." The inclusion of insurance at all in the Article 9 definition of proceeds is of recent origin, and the comments to the 1972 Official Text explaining the reasons for change have this to say: "The 'except∗ clause is intended to say that if the insurance contract specifies the person to whom the insurance is payable, the concept of 'proceeds∗ will not interfere with performance of the contract." The

Model Act, and the other Canadian versions of the Act, contain no such limitation on the inclusion of insurance.

This problem is not likely to arise frequently, but it seems nevertheless to be one of some difficulty. It would be tiresome to set out at great length different possible approaches to the problem of conflicting interests in insurance proceeds in view of the infrequency with which the problem is likely to be encountered. We therefore simply state our preference.

On the whole, we do not believe that assignees of insurance moneys should be within the Act. But they must be brought within the Act to some extent if there is to be an insurance proceeds interest. This bifurcation of treatment is reflected in section 3 *(b)* of the Act, which provides:

> This Act does not apply
> *(b)* to a transfer of an interest or claim in or under any contract of annuity or policy of insurance except as provided in section 27 [the proceeds section].

This seems to be the correct solution. Rights under an insurance policy should not be brought within the Act, except that a proceeds interest should be granted automatically by the Act. In a priority contest, if the contestants are both secured parties claiming the insurance money as proceeds, the Act should apply to determine priorities. Otherwise the Act should not be involved. We believe our recommended section 3 (1) accomplishes this result without the need for any exception in the definition of proceeds such as that contained in Article 9. We therefore make no recommendation for change in the definition of proceeds on this point.

The provisions relating to proceeds in section 27 (2) indicate that "there is no perfected security interest in proceeds that are not identifiable or traceable." Article 9 contains a rather long subsection which sets out in detail the limits of the perfected security interest in proceeds. Most of these provisions are concerned with the extent to which cash or money placed in a bank account may be recovered as proceeds. We prefer the Model Act∗s approach of engrafting this question onto the present law of tracing. It is a familiar creature and does not have the appearance of arbitrariness which the provision in Article 9 suggests.

There is, however, some difficulty with the present treatment of the tracing provision in the proceeds section. First, to say that "there is no perfected security interest in proceeds that are not identifiable or traceable" suggests that there may still be a security interest in such proceeds, albeit unperfected. We believe the word "perfected" should be omitted here. Secondly, it is not clear whether the limit imposed by the doctrine of tracing is to apply only to a security interest in proceeds created and perfected by section 27 itself, or whether it is also to apply to a security interest in, for example, "inventory and the proceeds thereof" or "inventory and accounts therefrom," or even whether it is intended to apply to accounts which are in fact proceeds in the case of a security interest in "inventory and accounts." Part of this problem arises from the fact that the tracing provision is contained in section 27 and not in the definition of proceeds.

We can see no reason why the doctrine of tracing should be confined in its operation to the case of an automatically perfected security interest. The main difficulty is that there are three kinds of proceeds—section 27 proceeds, proceeds claimed as proceeds in the financing statement, and proceeds claimed as original collateral but which also happen to the proceeds of other original collateral. The problem of identifying the collateral so as to permit the security interest to continue to follow it into whatever form it takes is, in principle, the same in each of those cases. It is also possible, though not perhaps likely, that the same problem might arise in the case of original collateral which is not in fact proceeds, such as where a security interest is in fungibles or money.

There are difficulties and uncertainties which stem from the general law relating to rights *in rem* and we do not believe that an Act governing security interests should seek to resolve them. In so far as it is necessary to accommodate parts of the Act to the general law, the Act must, if it is to be kept within reasonable bounds, take that general law as it finds it. We believe, however, that the Act should make clear which principles are to apply in what situation, even if there may be areas of difficulty in the application of these principles.

Besides the difficulties surrounding tracing collateral and its proceeds, two other provisions might be mentioned as raising possibly similar questions. Section 10 of the Act requires, as one of the two alternative "Statute of Frauds" conditions, that the debtor have signed a security agreement "that contains a description of the collateral sufficient to enable it to be identified."[13] Section 47 (1), which sets out what information must be contained on the register in order for the security interest to be perfected, also requires that there be "a description of the collateral sufficient to identify it." What relationship do those provisions have to difficulties of tracing collateral and proceeds?

We believe the better view to be that sections 10 and 47 do not bear directly upon the tracing problem. They are concerned with the creation of an enforceable or perfected security interest in certain collateral; they are not ostensibly directed at determining what shall happen in the light of the subsequent history of the collateral. No doubt they could be made to perform a tracing function, but the prime object of these provisions is to ensure that reasonable notice is given to third parties of the existence of a security interest. This is a different function from determining the extent to which the secured party can continue to treat his security interest as effective.

We believe that the requirement that the collateral or proceeds continue to be identifiable or traceable is one which should apply to any collateral, whether it be original collateral or proceeds. In the case of original collateral, the main problems occur with goods and money. Section 38 of the Act, which relates to commingled goods, provides that where goods that are subject to a security interest become part of something else so as to lose their separate identity, the security interest attaches to the new thing of which the collateral is now a part. This is an analogue of the doctrine of tracing. In the case of a security interest in original collateral which takes the form of

money, the natural instinct of a lawyer or judge would be to look to the equitable rules of tracing. This is adequate for the few occasions on which the problem is likely to arise.

The only case which calls for clarification is that of proceeds. The provisions which relate to the following of proceeds would be clearer if the requirement of identification or traceability were contained in the definition of proceeds rather than in section 27. It could, of course, be argued that since the definition of proceeds in section 1 *(r)* is only a definition of the term as used in the Act itself, simply to alter the definition of proceeds will not necessarily mean that that word as used in a security agreement or financing statement will be construed correspondingly. This is technically true. But if there are disputes about the meaning of "proceeds" in a security agreement or financing statement, it is very likely that the Act∗s definition of proceeds will be referred to for guidance.

The Commission recommends:

1. The definition of "proceeds" in section 1 (r) of the Act be modified by adding the words "identifiable or traceable" before and to qualify the words "personal property."

2. Section 27 (2) of the Act be modified by omitting the words "but there is no perfected security interest in proceeds that are not identifiable or traceable."

An amended definition of "proceeds" which reflects the recommendations made in this section would read as follows:

> *"proceeds" means identifiable or traceable personal property in any form, or fixtures, derived directly or indirectly from any dealing with collateral, or the proceeds therefrom, and includes any payment received by way of damages, insurance, compensation, indemnity, or settlement in respect of loss of, or damage to, the collateral or proceeds therefrom, or any right to such payment, and any payment received by way of total or partial discharge of an intangible, chattel paper, or an instrument.*

D. The General Priority Rules

Section 35 of the Act provides:

(1) If no other provision of this Act is applicable, priority between security interests in the same collateral shall be determined

(a) by the order of registration, if the security interests have been perfected by registration;

(b) by the order of perfection, unless the security interests have been perfected by registration; or

(c) by the order of attachment under subsection 1 of section 12, if no security interest has been perfected.

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

These are the basic rules for determining priority between conflicting security interests in the same collateral, where none of the conflicting interests is regulated by one of the special rules of priority.

Section 35 (2) suggests the idea that when the mode of perfection of a security interest is relevant to determining which of section *35* (1) *(a)* (first-to-file) and section *35* (1) *(b)* (first-to-perfect) applies, a perfected security interest is to be treated as being always perfected in the way in which it was originally perfected. This rule applies to security interests that are "continuously perfected," and this expression is defined in section 23 (1) of the Act in the following way:

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

The general operation of section 35 is straightforward. Assuming there to be two conflicting security interests, it will normally be easy to ascertain by what manner each of them was perfected. If both were perfected by filing, the party who filed first has priority over the other party as to the collateral common to both security interests. If one, or both, parties perfected by a method other than filing, the applicable priority rule is first-to-perfect as to the part of the collateral claimed by both secured parties.

The first-to-file rule is an obvious and practical rule, based on the idea that the Act of filing puts later financers in a position to know what collateral is already subject to a security interest, or, if it is after-acquired property, what collateral is covered by the security interest. The first-to-perfect rule is designed to deal with situations where the first-to-file rule would be inappropriate because perfection occurred without any act of filing on the part of one or both of the secured parties.

Clearly, in applying the general priority rules to resolve a competition between conflicting perfected security interests in the same collateral, the first matter to be determined is the manner in which perfection was achieved. Equally clearly, unless the answer to this question is fairly obvious, there are likely to be difficulties in deciding whether first-to-file or first-to-perfect is the applicable priority rule. What then are the possible methods of perfection? There would seem to be four of them:

(a) perfection by registration (section *25);*
(b) perfection by taking possession of the collateral (section 24);
(c) perfection by operation of law (sections 26, 27, and 29);
(d) perfection as to goods held by a bailee other than one who has issued a negotiable document of title (section 28 (2)).

Section 35 (1), which sets out general priority rules, requires that the various methods of perfection be divided into two groups—those involving registration and those not involving registration. So far all is simplicity. The first of the four methods involves registration, whereas the second, third, and fourth do not. At this point in the discussion sections 28 (2) and 29 may be eliminated. Those concern goods held by a bailee and returned or repossessed goods. These provisions are considered elsewhere in this Report.

It seems quite clear that where the collateral is of a type in which a security interest can only be perfected by possession, only one party can have a perfected security interest. Thus, pri-

ority battles cannot occur. In the case of goods, however, a security interest may be perfected either by registration or by possession. Again, it seems clear that, if there are two secured parties, both of whom have perfected their security interests by filing, the first-to-file rule applies, but that if one of the secured parties has perfected by filing and the other by possession, the first-to-perfect rule must apply. Again, all is simplicity. We have so far considered, or eliminated, sections 24, 25, 28, and 29 without encountering any difficulty in determining the manner of perfection. We are left only with sections 26 and 27. These sections permit perfection by operation of law, and here the problems begin.

Section 27, for example, provides for the automatic temporary perfection of a security interest in proceeds. It will be recalled that the key issue is whether or not perfection occurs by registration or by some other method, since on this question may depend the question whether the first-to-file or the first-to-perfect rule of section 35 (1) applies. On the face of it, it would seem that a security interest perfected by operation of law is not one perfected by registration. But two other provisions of the Act must be borne in mind. First, section 27 (2) provides that the security interest in proceeds is "continuously perfected" if the security interest in their antecedents was perfected. Secondly, section 35 (2) provides that a continuously perfected security interest is to "be treated at all times as if perfected by registration if it was originally so perfected."

The difficulties which arise are perhaps best approached through an example: *S* has a security interest in goods perfected by registration and the debtor has sold the goods, giving rise to proceeds; *S* claims the proceeds, but finds that another secured party also claims them. To determine priority, one must ascertain whether the first-to-file or the first-to-perfect rule applies. Has $S*s$ interest in the proceeds been perfected by registration, or by some other method? His interest in the goods was perfected by registration. Does his registration encompass his interest in the proceeds as well? When sections 27 (2) and 35 (2), which provide continuity of perfection, are brought to bear, it may seem that the interest in the proceeds is to be treated as perfected by registration on the basis that the interest in the goods was so perfected. It is also probable that this is the intended result.

But a careful reading of these provisions, together with another provision of the Act, throws doubt on this view. The thing that is "continuously perfected" under section 27 (2) is only the interest in the proceeds, not the total security interest which consists of antecedents plus proceeds. Now, reading this into section 35 (2), the result is that "a continuously perfected security interest [the proceeds interest] shall be treated at all times as if perfected by registration if it [the proceeds interest] was originally so perfected." Was the proceeds interest originally perfected by registration? This was the question we set out to answer in the first place. It seems that a careful reading of sections 27 (2) and *35* (2) does not allow the conclusion that, if the antecedents were perfected by registration, the section 27 proceeds interest is also to be treated as so perfected.

Moreover, under section 12, a security interest can only attach when the debtor acquires rights in or to the collateral. This must mean that a security interest in proceeds can only attach when the debtor acquires a right to the proceeds. Prior to that time, he has no security interest in the proceeds, only in their antecedents. This fact tends to foreclose any argument based on section 35 (2) that the secured party has a single continuing interest which may take the form of antecedents or proceeds, but which, in any event, is to be treated as continuously perfected by registration if it was originally so perfected. The conclusion must be that here is a difficulty in determining the manner of perfection of a security interest. Since this question is crucial to the operation of the general priority rules, it must mean there is ambiguity in those rules.

Another problem here is to determine the time of perfection. Since priority may depend on the time of perfection, this is also a crucial matter. Consider again the example of a security interest in goods, perfected by registration, which are then sold and produce proceeds. If one concludes that in view of sections 27 (2) and 35 (2) and the argument based on continuity of perfection, the interest in the proceeds is to be treated as perfected by registration and assuming the competing secured party has also perfected by registration the first-to-file rule applies and no difficulty arises. All one must do is to examine the respective dates of registration.

If, however, one concludes that the proceeds cannot be treated as having been perfected by registration, the applicable rule is first-to-perfect. When was the security interest in the proceeds perfected? Did it occur at the time of registration against the original goods or at the time section 27 (1) operated to cause the proceeds interest to be perfected? Again the answer is unclear. It might be thought that the intent of the continuity of perfection provisions is that, for priority purposes, the interest is meant to be treated as a single continuing interest, its priority being determined by the date of the original registration or at least at the time of perfection of the original security interest. The difficulty with this argument is that, before the proceeds are generated by the sale of the goods, the debtor has no interest in them. Under section 12, no security interest in them can therefore attach until that time and, according to section 21, a security interest cannot be perfected until it has attached. It is therefore difficult to see how the security interest in the proceeds can be perfected before the debtor acquires some right to them. Hence the fact of a previous registration against the antecedents seems to be irrelevant in determining the time of perfection as to the proceeds. Here again there appears to be ambiguity in the operation of the general priority rules.

The basis of the ambiguity lies in the uncertainty surrounding the question whether a security interest is a single composite interest with a priority determined at the moment it is first perfected, or whether it is a series of discrete security interests, each attracting a priority independently of the others. The ambiguity results from the fact that the Act seems to use the term "security interest" in two different senses. The first sense is that a security interest is an interest in a particular item of collateral (the separate security interests theory); the second sense is that a security interest is that class of things embraced by the first sense (the composite security interest theory.) Clearly, from the point of view of existence and enforcement, a security interest cannot come into being until there is something in the form of collateral for it to grasp and it can only be

extended in scope as and when new pieces of collateral are acquired by the debtor. The definition of attachment reflects this view. From the point of view of priority, however, it is possible to contemplate that the security interest referred to in the general priority rules is a reference to the class or set of individual security interests such that it is correct to use the term "security interest" when one member of the class is a security interest which has attached, and it is correct to use the term "perfected security interest" when one member of the class is a perfected security interest. In our view the Act does not clearly resolve this dichotomy, and the operation of the general priority rules should be clarified if the Act is to be incorporated into the law of this Province.

In our opinion a secured party whose security interest is perfected by filing should always be able to rely on his date of filing as being the time at which his priority is established. The fact that a competing secured party has perfected his security interest by a method other than filing does not seem an adequate reason why the party who has filed should not be able to rely on the date on which he filed for the purposes of determining priority. The effect of building such a provision into the Act would be that, for purposes of priority between two consensual security interests, the composite security interest theory is preferred to the discrete security interests theory.

It would be wrong to conclude that this would be a fundamental change in the policy expressed in the Model Act. A number of points should be borne in mind. First, our suggestions refer only to priority between competing secured parties. As to creation and enforcement of a security interest, the composite interest, or continuing general lien, is already embodied in the Act in the provisions relating to after-acquired property, proceeds, and future advances. Secondly, the kind of priority to which we are referring is priority between two people whose interests are both regulated by the personal property security system. It has no bearing on a competition between someone claiming an interest under the personal property security system and someone who claims an interest under some other priority system.

E. The 1972 Official Text of Article 9

The 1972 Official Text of Article 9 embodies a major revision of the general priority rules. The Model Act and the Ontario Act both based their general priority rules on the 1962 Official Text and, since that has now been revised by the 1972 version, it is felt that the amendments made by that version to the general priority rules deserve examination. Section 9-312 (5) provides:

> In all cases not governed by other rules stated in this section ...priority between conflicting security interests in the same collateral shall be determined according to the following rules:
>
> *(a)* Conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected, whichever is earlier, provided that there is no period thereafter when there is neither filing nor perfection.
>
> *(b)* So long as conflicting security interests are unperfected, the first to attach has priority.

This provision is comparable to section 35 (1) in the Model Act. It will be seen that clauses *(a)* and *(b)* of the Model Act are merged into clause *(a)* in the 1972 Official Text.

The equivalent of section 35 (2) of the Model Act is to be found in section 9-312 (6) of the 1972 Official Text. Prior to the 1972 Official Text, section 9-312 (6) and section 35 (2) were substantially the same. The 1972 Official Text contains a revised section 9-312 (6), which provides:

For the purposes of subsection *(5)* [quoted above] a date of filing or perfection as to collateral is also a date of filing or perfection as to proceeds.

F. Our Conclusion

We agree with the approach to the general priority rules adopted by the 1972 Official Text. The great difficulty inherent in the general priority rules contained in the Model Act is that, in some situations, it is difficult to tell by what manner a security interest was perfected and at what time it was perfected. The effect of the amendments contained in the 1972 Official Text is to make the former question irrelevant and to supply a simple answer to the latter question.[20] Subject to drafting modifications, we believe these changes should be adopted.

The Commission recommends:

Section 35 of the Act be modified to conform in principle to section 9-3 12 (5) and (6) of the 1972 Official Text on Article 9, and should provide as follows:

"(1) If no other provision of this Act is applicable, priority between security interests in the same collateral shall be determined

(a) by the order of registration or perfection, whichever is earlier; and

(b) as between unperfected security interests, by the order of attachment.

(2) For the purposes of subsection (1) a date of registration or perfection as to collateral is also a date of registration or perfection as to its proceeds."

Besides this change in operation of the general priority rules, we believe that section 27, which provides for a security interest in proceeds, ought also to be amended.

Section 27 (1) *(b)* creates the security interest in proceeds by causing that interest to "extend" to the proceeds. Section 27 (2) provides:

The security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected but it ceases to be a perfected security interest and becomes unperfected ten days after receipt of the proceeds by the debtor unless

(a) a registered financing statement covers the original collateral and proceeds therefrom; or

(b) the security interest in the proceeds is otherwise perfected before the expiration of the ten-day period,

but there is no perfected security interest in proceeds that are not identifiable or traceable.

The object of section 27 (2) *(a)* is that, if the secured party has registered a financing statement and it covers "proceeds," the secured party has a perfected security interest in proceeds by virtue of the registration, even though the proceeds are a type of collateral for which registration is not an appropriate method of perfection.

The other Canadian drafts of the Code all provide for a similar result, and in this they follow the 1962 draft of Article 9. The 1972 version of Article 9, however, takes a different view. Section 9-3 06 (3) provides:

> The security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected but it ceases to be a perfected security interest and becomes unperfected ten days after receipt of the proceeds by the debtor unless
>
> *(a)* a filed financing statement covers the original collateral and the proceeds are collateral in which a security interest may be perfected by filing in the office or offices where the financing statement has been filed and, if the proceeds are acquired with cash proceeds, the description of collateral in the financing statement indicates the types of property constituting the proceeds; or
>
> *(b)* a filed financing statement covers the original collateral and the proceeds are identifiable cash proceeds; or
>
> *(c)* the security interest in the proceeds is perfected before the expiration of the ten-day period.
>
> Except as provided in this section, a security interest in proceeds can be perfected only by the methods or under the circumstances permitted in this Article for original collateral of the same type.

The effect of this provision is that a security interest in proceeds can only be perfected by registration if the proceeds-collateral is, so to say, registrable collateral. We adopt this principle as we regard it as an improvement on the Canadian drafts. Another feature of section 9-3 06 (3) is that, as long as the proceeds do take the form of registrable collateral, the secured party obtains a permanently perfected security interest in them by filing as to their antecedents. The theory behind this provision seems to be that since financers invariably contract for a security interest in the proceeds of collateral, they might as well be given one automatically, providing they register against the original collateral and the proceeds consist of registrable collateral. Our view on this point is that the secured party who wishes a permanently perfected interest in proceeds should be required ot go through the procedure of indicating on the reigster that he claims proceeds.

A third feature of section 9-3 06 (3) is its treatment of cash proceeds and their proceeds. According to Article 9, a security interest in cash can only be perfected by taking possession. If, however, the cash is claimed as proceeds, an exception is made, and a filing as to the antecedents of the cash perfects a security interest in the cash proceeds. The Model Act says nothing about security interests in cash, and this is perfectly understandable. In the normal course, people do not grant security interests in cash as original collateral. A security interest in cash is usually only claimed as proceeds and, as the Model Act is drafted at present, a perfected security interest may be claimed in cash proceeds if the secured party has registered against original collateral and proceeds. Under the principle we adopt in the previous paragraph, this result would no longer follow, since cash is not registrable collateral under the Act. We do not think that a secured party should be denied the right to claim a security interest in cash proceeds. Since this would be the effective result if no special accommodation for cash

proceeds was made, we favour an exception to the general principle that the proceeds must be registrable collateral in order for a filing as to proceeds to perfect a security interest in proceeds. We would therefore follow the American approach in dividing proceeds into the two categories of cash and noncash proceeds. If a financing statement is expressed to include proceeds, it should perfect an interest in cash proceeds, but a security interest in noncash proceeds should be perfected only if the collateral constituting the proceeds is registrable collateral.

Article 9 has what we believe to be a useful innovation relating to the proceeds of cash proceeds, things bought with cash, which is the proceeds of collateral. The definition of proceeds in all the drafts of the Code which we have considered includes the proceeds of proceeds. The difficulty with allowing a security interest to follow collateral through several different transactions is that the single word "proceeds" appearing on the financing statement gives no clue to the kinds of items that are included within the security interest. Thus, a security interest may attach to a motor-vehicle, then to an account generated when the vehicle is sold, then to the cash received in discharge of the account, and then to some garage equipment bought with the cash. In those circumstances a potential mortgagee of the equipment may be misled into believing that the equipment is free of the motor-vehicle interest, when in fact the equipment is proceeds and hence is caught by that interest. The effect of Article 9 is to prevent this situation occurring by cutting off the proceeds interest at the point at which cash proceeds are spent unless the proceeds interest also describes the types of collateral intended to be embraced by it.

The Commission recommends:

Section 27 (2) of the Act be modified so as to provide:

(2) The security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected, but it ceases to be a perfected security interest and becomes unperfected ten days after receipt of the proceeds by the debtor unless

(a) a registered financing statement covers the original collateral and proceeds therefrom and the proceeds are collateral in which a security interest may be perfected by registration in the office or offices where the financing statement has been registered and, if the proceeds are acquired with cash proceeds, the description of collateral in the financing statement indicates the types of property constituting the proceeds; or

(b) a registered financing statement covers the original collateral and proceeds therefrom and the proceeds are cash proceeds; or

(c) the security interest in the proceeds is otherwise perfected before the expiration of the ten-day period.

(3) Proceeds consisting of money and cheques (including bank accounts into which they may be paid) are cash proceeds and other forms of proceeds are noncash proceeds.

(4) Except as provided in this section, a security interest in proceeds can be perfected only by the methods or in the circumstances permitted in this Act for original collateral of the same type.

CHAPTER X THE PRIORITY SYSTEM: RECEIVABLES FINANCING

A. Introduction

One of the most significant features of Article 9 of the Code and its Canadian counterparts is the principle of recognizing the different patterns of secured financing to be found in the commercial and industrial world. Of course, individual financing arrangements are of infinite variety, but general patterns of financing are discernible; and one of the major modes of financing is based on the grant of an interest in the debtor∗s receivables.

A person∗s receivables are the rights to payment he has earned. The Model Act divides receivable into three categories and establishes different rules of priority for each category. These three categories are chattel paper, accounts, and instruments, and they will be examined in this chapter.

B. Chattel Paper

1. SOME CHARACTERISTICS OF CHATTEL PAPER AND ITS TREATMENT UNDER THE MODEL ACT

Chattel paper is a form of collateral. It consists of two elements, and in order for a security interest in it to exist, two separate transactions and three separate parties are necessary. In the first-level transaction, a person makes a loan to another secured by the grant of an interest in goods. The precise form of this first-level transaction is immaterial. It may be a conditional sale, or a chattel mortgage; the goods may be inventory, equipment, or consumer goods. In each case the transaction satisfies the first-level requirements for the generation of chattel paper. Once the first-level transaction is complete, a security interest in goods exists and it secures a right to payment. At this stage, no security interest in chattel paper exists, merely a security interest in goods.

The second-level transaction occurs, and with it the birth of a security interest in chattel paper, when the secured party assigns his right to receive the payment, together with his interest in the goods securing first right. In essence, the grant of a security interest in chattel paper is an assignment of a secured debt.

It would have been possible to disregard the existence of a pattern of financing whereby a debt secured by an interest in goods is assigned. The consequence would have been that such an assignment would have been treated by the Act as an assignment of the two separate constituent parts. Those two parts are, of course, the debt and the security interest in goods. The rules of perfection and priority that are laid down for assignments of debts and of security interests would then have been applicable. However, since so much receivables financing takes the form of chattel paper financing, and since the assignment of a debt combined with a security interest in goods does, in one sense, amount to something more than the sum of the parts, both the Code and the Model Act treat chattel paper as a separate species of collateral.

The additional something attributable to chattel paper over and above the sum of its constituent parts is the practice among business men of treating chattel paper as a type of quasi-negotiable instrument. A conditional sale agreement and a chattel mortgage are documentary evidence of a secured debt. According to one common form of financing the financer takes possession of the chattel paper. In the case of simple loan agreements, there is no general practice of granting a loan and then discounting it by transferring possession of a document evidencing the loan. This is no doubt because simple loans are generally not discounted at all. The people who make simple loans are professional lenders, in the business of making loans. In the case of conditional sales agreements, this is not the case. Conditional sellers are generally dealers who may find it difficult or impossible to leave large amounts of capital tied up in the form of, what are effectively, loans to customers. Such people are inclined, therefore, to discount the chattel paper they collect, and it is no doubt this fact that has given to chattel paper, but not to documents evidencing simple loans, their quasi-negotiable quality.

This practice of treating chattel paper as quasi-negotiable is given explicit recognition in the Code and in the Model Act. A security interest in chattel paper may be perfected either by filing or by taking possession of the collateral. As a general rule, however, the secured party who takes possession will be better protected than the one who simply files.

2. THE DEFINITION OF CHATTEL PAPER

Section 1 *(c)* of the Model Act provides:

"chattel paper" means one or more than one writing that evidences both a monetary obligation and a security interest in specific goods.

This conforms to the definition contained in the Uniform Act and the Ontario Act. The Catzman Committee and the Ontario Law Reform Commission both omitted any reference to "specific goods." The underlying security interest need not be in goods at all according to these drafts. We do not pursue the implications of such an extension of the concept of chattel paper. Suffice it to say that there does not appear to be any need to give quasi-negotiable status to assignments with underlying security interests in other forms of collateral, since no such patterns of financing have evolved. We believe that, in order for chattel paper to be generated, the underlying security interest should be restricted to goods.

Article 9 gives a definition of chattel paper that is slightly more elaborate, and, in one respect, distinctly broader than that contained in the Model Act. Section 9—105 (b) provides:

> "chattel paper" means a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods, but a charter or other contract involving the use or hire of a vessel is not chattel paper. When a transaction is evidenced both by such a security agreement or a lease and by an instrument or a series of instruments, the group of writings taken together constitutes chattel paper.

The Article 9 definition of chattel paper is wider than the Model Act∗s definition in that it includes monetary obligations arising under leases of specific goods. In the Model and Uniform Acts, leases of goods are divided into two categories—those that reserve security interests and those that are not intended as security. Despite the form in which a lease of goods is expressed, if it in fact has a security function, it is within the scope of the Act∗s definition of security interests. But leases of goods that do not have a security function are outside the Act. In terms of the Model Act∗s definition of chattel paper, the significance of this is that where a monetary obligation accompanied by a security lease is assigned, the assignee receives an interest in chattel paper. But if the lease is a nonsecurity lease, under the Model Act, an assignee of the monetary obligation and the lessor∗s interest does not obtain an interest in chattel paper. Under Article 9, even though the underlying interest is a nonsecurity lease, the assignee still acquires an interest in chattel paper.

We have recommended that even nonsecurity leases should be deemed to create security interests providing their duration is one year or more. Thus, if we were to adopt the Model Act definition of chattel paper, all assignments of monetary obligations accompanied by security leases and nonsecurity leases of one year or longer would be assignments of chattel paper. Our position would then be somewhere between that of the Model Act and Article 9. However, on this point we believe Article 9 to be superior to the Model Act. It seems to us that, where receivables arising out of lease are assigned, the transaction is functionally indistinguishable from the assignment of chattel paper. We would, therefore, include within the definition of chattel paper *any* monetary obligation due in respect of a lease of personal property.

To this we would make one exception. This is in connection with the hire by lease of a ship, a transaction generally known as a charter by demise. Analytically, it may seem odd that this one form of leasing arrangement should be treated differently from all others, but functionally the distinction is perfectly sound. The practice of chartering ships by demise substantially antedates the growth of leasing as a security device. Chartering by demise did not originate as a financing device, and it does not have that function today. In addition, most types of leasing for any significant period concern equipment/collateral. The context of equipment financing is quite different from the rather specialized world of shipping. We do not, therefore, regard the conceptual similarity between leases of equipment and leases of ships as sufficient reason for similar treatment. We would, therefore, exclude charter-parties from the definition of chattel paper, as has been done under Article 9.

There is a further feature of the definition of chattel paper that calls for comment. In order for chattel paper to exist, there must be "a security interest in specific goods." This is so under the Model Act and according to Article 9. We have already mentioned that we believe the kind of security interest that should be required for the generation of chattel paper should be one in goods, and in this respect we differ from the Catzman Committee and the Ontario Law Reform Commission. But we are uncertain about the implication of the reference to "specific goods." One obvious association the term might have is with the *Sale of Goods Act* section 2 of which provides that "'specific goods∗ means goods identified and agreed upon at the time a contract of sale is made." If this is the sense of "specific goods," it would seem to exclude goods which start off by being unascertained but later become ascertained.

An example might help. We refer to the debtor in the first-level transaction as the "obligor," the debtor in the second-level transaction as the "debtor," and the assignee of the chattel paper as the "financer." If the obligor grants a mortgage of personal property to the debtor, various situations are possible. The mortgage may be of certain identified goods, or it may be of "all goods situated at..." or it may be of after-acquired goods. Presumably the mortgage of identified collateral is a security interest in specific goods. What is the status of the "all goods" type mortgage? Does the attachment of a security interest to after-acquired goods as and when the obligor acquires rights in them turn those goods into "specific goods?" Does the answer to this question depend in some degree on how "specific" is the description of the after-acquired goods to which the security interest is to attach?

If the *Sale of Goods Act* sense of "specific" is intended, it may well be that only a security interest in goods in which the obligor has rights at the time the security interest is granted can be a security interest in specific goods. Thus, any goods acquired subsequently, even though they were subject to the security interest, would not generate a "security interest in specific goods." Moreover, if there were an interval of time between making the security agreement and its attachment, goods acquired in the meantime, even though subject to the security interest, might not be "specific goods."

While the Model Act does not include a formal definition of "specific goods," the general sense of the *Sale of Goods Act* definition seems to be *mutatis mutandis,* what was intended. The reference to "contract of sale" would have to be read as "security agreement."

The general effect of this construction is to exclude from the definition of chattel paper a debt secured by a floating lien on the obligor's goods. Indeed, no security interest which included after-acquired property could generate chattel paper, subject to rather far-fetched possibilities of a security interest in present and after-acquired goods being partly chattel paper and partly nothing but a security interest in after-acquired goods. We are not disturbed by the apparent exclusion of debts secured by floating liens on goods from the definition of chattel paper. The special rules associated with chattel paper are designed to give recognition to a particular type of receivables financing in which the debtor discounts his secured receivables. This practice occurs mainly in connection with equipment sales and retail sales, floating liens are not usually taken by people who discount their receivables. There is thus no pattern of financing in which a debt secured by a floating lien is likely to be discounted, and certainly no practice of treating floating liens as quasi-negotiable. We, therefore, agree with this restriction of the definition of chattel paper to security interests in "specific goods." It is our view, however, that a definition of specific goods should be included to reduce uncertainty. A consequential amendment to section 29 will also be necessary.

The Commission recommends:

1. *The definition of "chattel paper" in section 1 (c) of the Act be modified so as to provide as follows:*

   "'chattel paper∗ means one or more than one writing that evidences both a monetary obligation and a security interest in, or a lease of, specific goods, but chattel paper does not include a charterparty."

2. *A definition of "specific goods" be added to section 1 of the Act in the following terms:*

   "'specific goods∗ means goods identified and agreed upon at the time a security agreement, or lease, in respect of those goods is made."

3. *Section 29 (3) (b) of the Act be modified by adding the words "or lease" after the word "sale."*

3. THE SPECIAL RULES OF PRIORITY FOR CHATTEL PAPER

A security interest in chattel paper may be perfected either by registration or by taking possession of the paper.[3] This reflects the fact that two forms of chattel paper financing are common. The financer may take possession of the chattel paper and give no notice to the obligor of the assignment to him. This is most likely to be the pattern of financing when the chattel paper represents many transactions, each of a proportionately small amount, and is often referred to as "non-notification" financing. Under the present law the financer is in some danger of finding his interest subordinated to that of a later assignee of the debt due under the first-level transaction if the later assignee gives notice to the obligor. This is in accordance with the rule in *Dearle* v. *Hall.*[4]

The other common form of chattel paper financing is that in which the financer ensures his priority over subsequent assignees of the debt due from the obligor by giving notice to the obligor. The financer may also require payment to be made to him directly by the obligor.

The rule in *Dearle* v. *Hall* has never been entirely satisfactory as a rule of priority, and the Model Act abandons it. In many cases, the number of debts assigned to the financer make the giving of notice of each debtor impracticable, and even where the giving of notice is attempted it is often difficult to avoid time-lags between the assignment and the giving of notice. The financer∗s priority would always be at risk during each period.

Under the Model Act, registration replaces notice to the debtor as a method of establishing priority to a debt. The other mode of perfection permitted under the Act in respect of chattel paper, taking possession, reflects the growth of non-notification financing in the retail sector. This form of financing is, so to say, granted legal recognition under the Act in that possession of the chattel paper constitutes perfection and hence establishes priority.

The two different methods of perfecting a security interest in chattel paper are not treated alike for the purpose of measuring priority in the Model Act. The policy of the Act is to give emphasis to the quasi-negotiable quality that chattel paper has acquired in the eyes of financers. The special priority rule embodying this policy is contained in section 30 (3). It provides:

> A purchaser of chattel paper who takes possession of it in the ordinary course of his business has, to the extent that he gives new value, priority over any other security interest in it
>
> *(a)* that was perfected under section 25 if he did not actually know at the time that the chattel paper was subject to a security interest; or
>
> *(b)* that has attached to proceeds of inventory under section 27, whatever the extent of his knowledge.[5]

The Ontario Act, the Catzman Committee Report, the Ontario Law Reform Commission Report, and the Uniform Act contain similar provisions. Section 9-308 of Article 9 contains a broadly similar provision, although there are significant differences in scope and wording.

We agree with the policy of giving recognition to the quasi-negotiable quality of chattel paper. In principle, we favour adoption of section 30 (3). Its effect is that, although perfection of a security interest in chattel paper may be achieved by registration, a later secured party can defeat the earlier perfected security interest if he takes possession in the ordinary course of business, gives new value, and falls within paragraph *(a)* or *(b)*. The first secured party can, of course, insist on taking possession himself, thereby removing any vulnerability to later security interests, or, if this is impracticable, he can stamp the chattel paper so as to put a subsequent secured party on notice of the existence of his security interest.

We believe there may be abiguity in the drafting of section 30 (3) *(b),* although the policy is clear. A dealer may receive two kinds of financing— one on the security of his inventory, one on the security of his receivables, including chattel paper. The inventory security interest may extend to proceeds, either because "proceeds" are claimed in the security agreement and financing statement or under section 27. If an item of inventory is sold, it may generate chattel paper. The inventory financer and the chattel paper financer will now both be able to claim a security interest in the chattel paper, the former as proceeds and the latter as original collateral. Paragraph *(b)* of section 30 (3) expresses a policy preference for the receivables financer.

The difficulty lies in determining how many different forms of proceeds interests are subordinated to the chattel paper interest. The inventory financer may claim to be entitled to a security interest in chattel paper proceeds in any of the following circumstances:

(1) The security agreement and financing statement make no mention of anything but "inventory," leaving only section 27 on which to have a claim to proceeds;

(2) The security agreement provides for a security interest in "inventory and the proceeds of inventory";

(3) The security agreement provides for a security interest in "inventory and such chattel paper as constitutes the proceeds of inventory";

(4) The security agreement provides for a security interest in "inventory and chattel paper."

In general terms, the problem is to decide whether the existence of a section 27 proceeds interest renders otiose the proceeds interest provided for in the security agreement. In the four cases set out above, case 1 would seem to fall squarely within paragraph *(b)*. But in cases 2, 3, and 4 the proceeds interest arises both under section 27 and by virtue of the security agreement. Are then cases 2, 3, and 4 instances of a security interest "that has attached to proceeds of inventory under 27," with the result that section 30 (3) *(b)* gives priority to the possessory chattel paper interest?

We believe quite tenable arguments could be made on both sides of this question. Rather than rely on what seems the more likely interpretation, we favour removing the ambiguity.

The proper solution, in our view, is that a security interest in "proceeds," whether arising under section 27 or provided for in the security agreement, should fall within paragraph *(b)*. This

would include cases 1 and 2 referred to above. A security interest in "chattel paper" claimed as original collateral on the other hand, even if confined to chattel paper that was proceeds of inventory, should be outside paragraph *(b)*.

The Commission recommends:

Section 30 (3) of the Act be modified so as to provide:

A purchaser of chattel paper who takes possession of it in the ordinary course of hs business has, to the extent that he gives new value, priority over any other security interest in it except a security interest claimed as the proceeds of equipment

(a) that was perfected uMer section 25 if he did not know at the time that the chattel paper was subject to a security interest; or

(b) that has attached to proceeds of inventory under section 27, whatever the extent of his knowledge; or

(c) that is perfected as to the proceeds of inventory by a registration that refers only to proceeds without expressly mentioning chattel paper, or types of collateral that are chattel paper, whatever the extent of his knowledge.

C. Receivables Financing and Transfer of the Collateral

We turn now to a group of priority matters which raise similar questions. They concern the situation where a security interest is transferred by the secured party or the collateral is transferred by the debtor. These problems are likely to arise most often in the area of receivables financing, although certain aspects could arise in other contexts. They can, however, be most conveniently discussed in a single section.

Some examples will demonstrate the nature of the problem. Suppose *D,* a vendor, sells goods on credit to *B1*, a buyer. *B1's* debt to *D* in respect of the goods is an account. If *D* now assigns the account to *SP1, SP1* has a security interest (whether or not the assignment is intended as security). What happens if *B1* pays *D* instead of *SP1*? What happens if *B1* and *D* vary their contract to the detriment of *SP1*'s security interest? Suppose the sale to *B1* to have been a conditional sale. This would generate chattel paper and *SP1* would have a security interest in chattel paper (again, whether or not the assignment to *SP1* was intended as security). Suppose now that *SP1* reassigns the chattel paper to *SP2* and that *B1* sells the goods to *B2* who sells to *B3*. How does *SP2* ensure that he gets paid and not *D* or *SP1?* Are *B2* and *B3* bound by the conditional vendor∗s interest? Do they remain bound by it when it is assigned as part of chattel paper to *SP1* and *SP2?* In what circumstances are they bound?

These different questions do not all focus on the same point, but they raise related issues. For this reason we discuss them all under this heading, although for clarity∗s sake we group the different issues under different subheadings.

1. THE SECURITY INTEREST IN CHATTEL PAPER AND ACCOUNTS: PAYMENT TO WHOM?

Whether *B1* has bought a conditional sale (generating chattel paper) or credit sale (generating an account) he owes the price to *D.* But *D* may have assigned the account or chattel paper to *SP1*. Under the present law, the assignee, *SP1,* is required to give notice to the debtor, *B1*, to preserve his priority. This is the rule in *Dearle* v. *Hall.* Moreover, the effect of giving notice to the debtor is to prevent the debtor obtaining a good discharge for the debt by payment to *D.* Notice therefore serves the dual function of preserving priority and ensuring that the debtor does not pay the wrong person.

Under the Model Act, the priority of a security interest in an account may only be established by registration and in chattel paper by registration or possession. The question therefore arises, how should the problem of ensuring payment to the right person be dealt with? Section 40 (3) of the Model Act provides:

> The debtor on an intangible or chattel paper may pay the assignor until the debtor on an intangible or chattel paper receives notice, reasonably identifying the relevant rights, that the account has been assigned, and, if requested by the debtor on an intangible or chattel paper, the assignee shall furnish proof within a reasonable time that the assignment has been made, and, if he does not do so, the debtor on an intangible or chattel paper may pay the assignor.

The Ontario and Uniform Acts, the Reports of the Ontario Law Reform Commission and the Catzman Committee, and Article 9 contain similar provisions. The effect of these provisions is to preserve the part of the rule in *Dearle* v. *Hall* relating to discharge by payment to the assignor prior to receipt of notice of the assignment. The principle applies equally to subsequent assignments by the assignee. The subsection does not specify that this is so, nor, indeed, does it specify that the debtor may pay the first assignee after receipt of notice of the assignment. The implication is sufficiently obvious.

The Commission agrees with this provision and would make no recommendation for change.

2. ASSIGNMENT OF A SECURITY INTEREST

Where *D,* a dealer, sells goods on conditional sale, the dealer obtains a security interest. If the dealer registers his security interest, but then assigns the chattel paper to *F,* a financer, what is the status of the security interest in the hands of *F?* Section 23 (2) provides:

> An assignee of a security interest succeeds in so far as its perfection is concerned to the position of the assignor at the time of the assignment.

The Ontario and Uniform Acts, and the Report of the Ontario Law Reform Commission and the Catzman Committee, contain the same provision. We agree with it. The Model Act, and the other Acts, also contain provisions in the part of the Act dealing with registration which permit the assignee to become the "secured party of record" on filing of a "statement of assignment."

3. EQUITIES ARISING BETWEEN DEBTOR AND ASSIGNOR

The general principle in the law of assignment has been that an assignee takes subject to equities. That is to say that any defence a debtor may have against his assignor in respect of the debt also binds the assignee, provided it arises before the debtor receives notice of the assignment. This general principle is preserved in section 40 (1) of the Model Act. It provides:

> Unless a debtor on an intangible or chattel paper has made an enforceable agreement not to assert defences or claims arising out of a contract, the rights of an assignee are subject to
>
> *(a)* all the terms of the contract between the debtor on an intangible or chattel paper and the assignor and any defence or claim arising therefrom; and
>
> *(b)* any other defence or claim of the debtor on an intangible or chattel paper against the assignor that accrued before the debtor on an intangible or chattel paper received notice of the assignment.

The Ontario and Uniform Acts, the Reports of the Ontario Law Reform Commission and the Catzman Committee and Article 9 all contain similar provisions. We make no recommendation for change.

4. TRANSFERS OF GOODS SUBJECT TO A SECURITY INTEREST

In this situation, *D* has sold goods on conditional sale to *B1* or received a chattel mortgage from *B1*. The chattel paper generated by the sale has been sold to *SP1*. The question is, what happens if *B1* sells the goods to *B2* and if *B2* sells them to *B3?* Do *B2* and *B3* take subject to the security interest of *D,* which has now been assigned to *SP1?* The first point to note is that if *B1* is a trader and he sell the goods to *B2* in the ordinary course of business, *B2* "takes free from any perfected or unperfected security interest therein given by the seller . . . whether or not the buyer . . . knows of it unless he also knows that the sale . . . constitutes a breach of the security agreement. Sales by traders are discussed below. For present purposes we may assume the sale to *B2* and *B3* are not in the ordinary course of business nor are they private sales of certain consumer goods.

The Model Act provides in section 22 (1) *(b)* (i) that if a secured party or his assignee has not perfected his security interest, an innocent purchaser takes free of it to the extent that he gives new value. But if the secured party has perfected his security interest, no provision of the Model Act is applicable. That being so, the general rule of *nemo dat* applies and *B1* and *B2* both take subject to the security interest. This raises a difficulty.

Assume that *D* has registered his conditional seller∗s interest. The principle of the Act is that *B2* is bound by it because if he conducted a search in the name of *B1,* he would discover *D∗s* security interest. But when *B3* comes to buy from *B2,* he will find no security interest in the goods registered against *B2's* name. Thus, B3, an innocent purchaser for value, is bound by a security interest which he had no means of discovering. This particular problem is sometimes referred to as the *A -B-C-D* problem. *A* is the secured party and *B* buys from him and grants a security interest. *C,* the sub-buyer, can discover this security interest by an appropriate search. But if a subsale takes place to *D,* no means of discovering *A∗s* security interest exists.

The Act is not bereft of provisions which relate to this situation, but they are of limited effect. Thus, returning to the *D-B1-B2-B3* terminology, if *D* consents to a sale of the collateral by *B1, D's* security interest becomes unperfected until *D* registers his security interest against *B2.* Section 49 (1) provides:

> Where a security interest has been perfected by registration and the debtor with the consent of the secured party assigns his interest in the collateral, the assignee becomes a debtor and the security interest becomes and remains unperfected until the secured party registers a notice in the prescribed form.

Again, if *D* actually learns of a transfer of the collateral by *B1* to *B2, D* must register against *B2* within 15 days. Section 49 (2) provides:

> Where a security interest has been perfected by registration and the secured party learns that the debtor has assigned his interest in the collateral, the security interest becomes unperfected fifteen days after the secured party learns of the assignment and the name and address of the assignee, unless he registers a notice in the prescribed form within fifteen days.

The Ontario and Uniform Acts and the Report of the Ontario Law Reform Commission contain similar provisions, although they allow a grace period of 15 days for section 49 (1) as well as section 49 (2).

We agree that if *D* consents to a sale by *B1* or discovers that *B1* has sold the collateral, *D* should be required to register his security interest against *B2* in order to preserve his security interest against an innocent purchaser from *B2.* It is our view, however, that this is insufficient protection for the innocent purchaser from *B2.* If the secured party did not consent to, or discover, a sale by *B1* to *B2,* a buyer from *B2* is defeated by a prior interest when he had no means of discovering the existence of the prior interest. This is, of course, one of those situations where one of two innocent parties may have to suffer as a result of the fraud, or at least neglect of a third. It is by no means obvious to us, however, that the one to suffer should be the innocent purchaser rather than the financer.

In terms of merits, the innocent purchaser perhaps deserves to be favoured. At least the financer has been prepared to advance finance to a dealer who in turn has been prepared to do business with someone who turns out to be a rogue. But this argument is tenuous. A sounder approach is to assume that there will inevitably be a certain number of losses as a result of frauds committed by people in the position of *B1,* and to determine how can those losses most fairly be absorbed.

The losses in question will not occur through the fault of the innocent buyer *(B3),* although the person *(B2)* who sold to him will be at fault for failing to disclose the existence of the security interest to *B3.* Primarily, therefore, in a *D-B1-B2-B3* situation, *B1* (the original debtor) and *B2* should be the parties at risk, and *B3* ought not to be at risk at all. If no recovery ts possible from *B1* and *B2,* the loss ought to be regarded as one for which some kind of insurance mechanism should be available. The best way of achieving this result is to allow the loss to fall on *D,* who is at least in a position to treat such anticipated losses as part of the cost of entering

into credit arrangements. *D* can then provide a cushion for that loss in the form of an appropriate increase in finance charges.

The net result is that if no one who is really at fault can be made to pay, instead of the loss falling on the innocent ultimate purchaser, it is distributed among all those persons who purchase goods of that kind on credit. This seems to introduce something akin to an insurance mechanism and to be a fair solution to the problem. It is, of course, likely to be a rare case where neither *B1* nor *B2* is worth suing but where it occurs, in our view the loss should be borne by the person best able to bear it and best able to distribute it as a loss falling on the community in general.

The Commission, therefore, adopts a principle according to which, when the debtor makes an assignment of his interest in the collateral to a first assignee, who then assigns the interest to a second assignee, the second assignee takes free of any security interest unless it is registered against the name of the first assignee. In addition, we believe that the first assignee should be liable in damages to the secured party since he is responsible for causing the security interest to be defeated. Section 49 achieves this result by making the assignee a "debtor."

The Commission recommends:

Section 49 of the Model Act be amended by omitting subsections (1), (2), and (3) and replacing them as follows:

"(1) Where a security interest has been perfected by registration and the debtor assigns his interest in the collateral the assignee becomes a debtor and

- *(a) notwithstanding paragraph (b) and (c), the security interest becomes and remains unperfected against purchasers for value of the collateral who do not know that the collateral was subject to a security interest, and against persons deriving title from such purchasers, if at the time of the purchase the secured party has not registered a notice in the prescribed form;*
- *(b) where the assignment was with the consent of the secured party, the security interest becomes and remains unperfected until the secured party registers a notice in the prescribed form;*
- *(c) where the secured party learns that the debtor has assigned his interest in the collateral, the security interest becomes unperfected 15 days after the secured party learns of the assignment and the name and address of the assignee, unless he registers a notice in the prescribed form within 15 days.*

"(2) A security interest that becomes unperfected under paragraph (b) or (c) of subsection (1) may thereafter be perfected by registering a notice in the prescribed form or as otherwise provided by this Act."

D. Priority Between Nonsecurity and Unperfected Security Interests in Chattel Paper

One of the complexities of a reasonably comprehensive scheme for regulating security interests is that there are two systems of priority to worry about. One system relates to priority between competing security interests and the other to priority between security interests and non-security interests. As to the former, the Model Act provides a complete scheme for resolving priority problems. As to the latter, the Act contains some provisions, although many matters are left for resolution under the general law.

Section 22 of the Act is one of the provisions that relates to priority between security and nonsecurity interests. General discussion of this provision is postponed, but we consider it here in the specific context of chattel paper and accounts. Section 22 (1) *(b)* provides:

> (1) Except as provided in subsection (2), an unperfected security interest is subordinate to.
> *(b)* the interest of a transferee who is not a secured **party to the extent** that he gives value without knowledge of the security interest and before it is perfected
> (i) in chattel paper, documents of title, securities, instruments or goods under a transfer in bulk or otherwise not in the ordinary course of business of the transferor, and where the transferee receives delivery of the collateral; or
> (ii) in intangibles.

"Intangibles," referred to in paragraph (ii), means all personal property not included in subparagraph (i) and includes accounts.

The basic effect of section 22 (1) *(b),* as it relates to chattel paper and accounts, is that a nonsecurity transferee of chattel paper or accounts defeats an unperfected security transferee, provided, in the case of chattel paper, the nonsecurity transferee takes possession.

It seems strange that chattel paper and accounts should have been included in this section. Section 2 of the Model Act provides that transferees of chattel paper or an account are subject to the Act, whether or not they take by way of security. In other words, any transfer of chattel paper or an account is deemed to create a security interest, regardless of whether it was in fact intended as security.

We believe that it should follow from this that all priority battles between transferees of accounts or between transferees of chattel paper present problems within the range of competing security interests, and should not give rise to problems involving the two different systems of priority—the system of security interest priority as opposed to other systems of priority.

With regard to chattel paper, the provision seems to do no harm, since in order for the nonsecurity transferee to defeat the unperfected security transferee, the nonsecurity transferee must take possession of the chattel paper.

This gives the nonsecurity transferee a perfected security interest which will defeat the unperfected security interest under the general priority rules contained in section 35.

Despite the fact that, with regard to chattel paper, section 22 (1) *(b)* seems to produce the same result as the general priority rules, we favour omission of the reference to chattel paper. It is unnecessary and may cause problems in relation to transferees of an absolute interest in chattel paper who know of an existing but unperfected security interest in that chattel paper. The absolute transferee is not within section 22 (1) *(b)* since his knowledge of the prior interest excludes him. Is the implication of section 22 (1) *(b),* therefore, that he is subordinated to the unperfected security interest even though he takes possession of the chattel paper and thereby perfects his interest? Such a result would be undesirable and inconsistent with the general policy in the Act of assimilating security and nonsecurity assignments of chattel paper.

With regard to accounts it seems to us that similar undesirable consequences follow. Once it is admitted that accounts are to be included within the Act, whether or not their assignment is intended as security, it ought to follow that priority between competing interests, whether security or non-security interests, depends on order of registration, and if neither party reglsters, upon order of attachment. Such a rule is clear, simple in operation, easy to understand, and causes no hardship to professional financers.

The Commission recommends:

Section 22 (1) (b) of the Act be modified so as to omit all reference to chattel paper and to confine the reference to intangibles to include only intangibles other than accounts.

E. Instruments

The Model Act provides that the rights of certain transferees of personal property, including those of holders in due course of negotiable instruments, remain subject to the applicable general law. Thus, section 31 of the Act provides:

> The rights of
> *(a)* a holder in due course of a negotiable instrument;
> *(b)* a holder of a negotiable document of title who takes it in good faith for value; or
> *(c)* a bona fide purchaser of securities,
> are to be determined without regard to this Act.

The Ontario and Uniform Acts and the Reports of the Ontario Law Reform Commission and the Catzman Committee contain the same or similar provisions. Those Acts and reports also contain a further subsection which is missing from the Model Act. It provides:

> Registration under this Act is not such notice as to affect the rights of persons in subsection (1).

In addition to this, section 30 (4) of the Act contains a special priority rule dealing with non-negotiable instruments. According to section 30 (4):

> A purchaser of a non-negotiable instrument who takes possession of it in the ordinary course of his business has priority to the extent that he gives new value over a security interest in it

that was perfected under section 26 if he did not actually know at the time he took possession that the instrument was subject to a security interest.

Until the 1972 amendment to Article 9, section 9-308 contained a similar provision, but that section has now been changed to overcome two anomalies that the earlier section seemed to produce. The first was that where the non-negotiable instrument was proceeds, a person who took possession of the lnstrument could not defeat a prior proceeds interest in it even if he did not know of the existence of that interest. This seemed odd when compared with the more favourable treatment given to the possessory interest in original chattel paper collateral as against the proceeds interest. The possessory interest in original chattel paper collateral defeated the proceeds interest (and the Model Act is to the same effect as Article 9 on this point), whether or not the former knew of the existence of the latter.

Under the most recent version of Article 9, section 9-308 *(a),* this problem is overcome by providing that the possessory interest in non-negotiable instruments defeats the proceeds interest. We believe that the Model Act should be amended to include a similar provision.

The second anomaly in the 1962 draft of Article 9, which has been corrected, was that, on a literal reading, the holder of a negotiable instrument who had knowledge of a prior proceeds interest (even, so it would seem, if that prior interest was unperfected, although this would not be likely to occur in practice) might be defeated by that interest, whereas, if the subject-matter of the conflicting claims had been chattel paper, the possessory interest would defeat the proceeds interest. The point was that if the holder of a negotiable instrument knew of a prior proceeds interest, he could not be a holder in due course and could not gain the benefit of section 31. His interest was, therefore, subject to the general priority rules. Without rehearsing again the complexity that they involved, the probable outcome would be that the prior proceeds interest defeated the possessory interest.

This anomaly has been overcome by providing that the possessory interest in negotiable instruments should defeat the proceeds interest. Again, we believe that this amendment should be adopted.

The Commission recommends:

Section 30 (4) of the Act be modified so as to provide:

A purchaser of an instrument who takes possession of it in the ordinary course of his business has, to the extent that he gives new value, priority over any other security interest in it, except a security interest claimed as the proceeds of equipment

(a) that was perfected under section 26 if he did not know at the time he took possession that the instrument was subject to a security interest; or

(b) that has attached to proceeds of inventory under section 27, whatever the extent of his knowledge; or

(c) that is perfected as to the proceeds of inventory by a registration that refers only to proceeds without expressly mentioning instruments, or types of collateral that are instruments, whatever the extent of his knowledge.

CHAPTER XI THE PRIORITY SYSTEM: PURCHASE-MONEY SECURITY INTERESTS

A. Introduction

The various Canadian and American versions of Article 9 all provide for a device known as the purchase-money security interest. The point of this type of security interest is that a party who has supplied new collateral to a debtor and taken a security interest in that collateral (vendor credit), or has advanced money to the debtor to facilitate the purchase of new collateral and has been granted a security interest in that collateral (lender credit), receives special protection under the Act∗s priority system. The expression "purchase-money security interest" refers to a security interest in new collateral in these situations.

In the absence of any special priority rule relating to purchase-money security interests, the general priority rules would apply. Thus, where the debtor has existing secured creditors whose security interest covers after-acquired property of the same type as the new collateral, assuming these earlier secured parties have registered their security interest, application of the general priority rules would usually give them priority over the later purchase-money security interest. The American draftsmen of Article 9 felt this would be an undesirable result, and the Canadian adaptions have taken a similar view.

The issue is one of policy. A debtor may have granted several security interests to several secured parties, but then find he needs still more credit. Assuming all the existing secured parties have registered their security interests, if the debtor approaches a new financer and requests credit, that new financer might be reluctant to advance credit if any security interest granted to him would be subordinated to existing security interests. This may mean that the debtor∗s access to further credit is cut short unless he can persuade his existing creditors to advance further credit. They may be unwilling to do this for reasons quite unconnected with the debtor∗s actual credit-worthiness.

One way to overcome the debtor's problem would be to allow the new financer priority over the existing secured parties. But if that were done generally, it would spell the ruination of the security interests as a financing device, since any secured party could lose his priority to any number of later secured parties. If the later secured party∗s priority over the earlier secured parties were, however, confined in extent to the amount of new money or value injected into the debtor∗s enterprise by the later secured party, the earlier secured parties would have less ground for complaint. Admittedly the later secured party is getting a priority, but only to the extent that he increased the value of the pool of assets in which the earlier secured parties are interested. But even this might not be sufficient reassurance for the earlier secured parties since once the

debtor has received this new injection of funds, he may use it to satisfy his more troublesome *unsecured* creditors. If the later secured party were given priority, despite such an appropriation by the debtor, the consequence for the earlier secured parties would be to dispose of one group of creditors over whom they had priority, and replace them with another creditor over whom they do not have priority.

Clearly top priority in return for new value may cause considerable harm to existing secured parties. If, however, the use to which the debtor can put this new value is restricted and it cannot be used to pay off existing unsecured creditors, but must be used in the purchase of new collateral, the early secured parties have much less ground for complaint. Although the later secured party has priority, he has it only to the value of new collateral actually obtained by the debtor out of funds provided by the later secured party. It is this interest, confined in scope to new collateral actually obtained by the debtor, that is protected and given a special priority in the Model Act. It is the purchase-money security interest.

Under present Canadian law, no special priority is afforded to the purchase-money security interest as such, although the same result is achieved through the reservation of title under a conditional sales agreement. In the United States, the special priority of a purchase-money security interest was well-known, even prior to the advent of Article 9 and had been established by the courts, in some contexts, in the latter half of the 19th century. But the differing history in the two countries is accounted for, not so much in terms of the pursuit of different policies, but in terms of different techniques for the pursuit of broadly similar policies.

In the United States, through a process of much vacillation and uncertainty, it came gradually to be accepted that security interests could be created in after-acquired property and these would prevail against creditors, purchasers, and trustees in bankruptcy. In Canada, on the other hand, the notion of a fixed charge in after-acquired property never gained the foothold that it did in the United States. By contrast, the United States never developed the theory of the floating charge, whereas in Canada corporate finance on the security of after-acquired assets is usually obtained through grant of a floating charge.

The effect of the floating charge is that, in appropriate circumstances, later security interests may be created which rank in priority to those of the earlier floating charges; whereas, as in the United States the after-acquired property interest was viewed as a fixed charge, some new device was needed. Hence, the interests that were to be recognized by the emergence of the purchase-money security interest in the United States were largely capable of accommodation within the framework of the floating charge in Canada.

Enactment of the personal property security system envisaged by the Model Act would facilitate the creation of fixed charges in after-acquired property. The same case that existed in the United States for the creation of specially favoured purchase-money security interests would then exist in this Province. Consequently, the Commission favours the principle of adopting a purchase-money security interest with a specially protected priority.

B. The Scope of the Purchase-money Security Interest

Section 1 *(s)* of the Model Act provides:

"purchase-money security interest" means a security interest that is
(i) taken or reserved by the seller of the collateral to secure payment of all or part of its price, or
(ii) taken by a person who gives value for the purpose of enabling the debtor to acquire rights in the collateral, if such value is applied to acquire such rights.

It will be seen that the case of a security interest taken by the seller of new collateral provided for in paragraph (i) of this definition is equivalent to the concept of the conditional sale under existing law. As mentioned above, conditional sale law presently gives priority to the conditional seller over existing secured creditors, but does this through the reservation of title in the conditional seller.

The elements discussed above, of providing new value that takes the form of new collateral or money which is spent in acquiring new collateral, are reproduced in this definition. The Ontario Act and Report, the Catzman Report, the Uniform Act, and Article 9 contain approximately similar definitions. On the basis that this type of security interest should receive special protection, the Commission agrees that this is an appropriate definition of the scope of the interest that should be protected.

The only points we would take in relation to the definition are matters of drafting. The first point lies in the last few words: "if such value is applied to acquire such rights." A financer might advance money to a secured party intending it all to be spent in the acquisition of new collateral. If the debtor spent only part of the sum advanced in acquiring new collateral and allocated the balance to some alternative use, what would be the status of the secured party's interest? In our view, it should continue to be treated as a purchase-money security interest to the extent that the money advanced was actually applied in acquiring new collateral. The present wording might, however, lend weight to the suggestion that, unless all of the money advanced is spent in acquiring new collateral, there can be no purchase-money security interest at all. We would therefore replace the words "if such value is applied to acquire such rights" with more appropriate language.

The second point again concerns paragraph (ii) of the definition. Under the present drafting, value must be given to enable "the debtor to acquire rights in the collateral," and the debtor then must "acquire such rights." If the debtor is hiring equipment and his rental payments are furnished by the secured party, there is no reason in principle why the secured party should not obtain a purchase-money security interest. As the definition is presently drafted, such a secured party∗s interest might not be caught, since the debtor would not necessarily acquire "rights in the collateral." The difficulties created by that expression have been discussed earlier in the context of the definition of attachment. We would therefore substitute the words "rights in or to collat-

eral" for the words "rights in the collateral." This is consistent with the language in our recommended definition of attachment.

Our final point concerns the application of the purchase-money security interest priority to transactions such as leases and consignments intended as security which do not clearly fall into the definition of "purchase-money security interest" and to nonsecurity transactions such as other leases over one year, and consignments which we have recommended be deemed to create security interests for the purposes of the Act.

The difficulty is that while such transactions have the effect of increasing the debtor's poo1 of assets, if they do not enjoy the priority of a purchase-money security interest, they may be defeated in some cases. For example, if a secured party, deemed or actual, consigns goods which are inventory to the debtor, and there is an earlier perfected security agreement which embraces after-acquired collateral of the same type, the operation of the general priority rules will give the earlier party priority. If the consignor does not have the status of a purchase-money secured party, registration will not improve his position. It is not obvious why this should be the case. There is no reason in principle why a lessor or consignor of collateral should be placed in a priority position less favourable than that given to a conditional seller of collateral.

As the definition is now drafted, the status of these transactions is uncertain. While it might be argued that the courts would construe the term "seller" broadly enough to encompass some of them, in our view the matter should be put beyond doubt.

The Commission recommends:

The definition of "purchase-money security interest" in section 1 (s) of the Act be modified so as to provide:

> *"purchase-money security interest" means*
>
> *(i) a security interest that is taken or reserved by a seller or lessor of collateral to secure payment of all or part of its sale or lease price; or*
>
> *(ii) a security interest that is taken by a person who gives value for the purpose of enabling the debtor to acquire rights in or to the collateral, to the extent that such value is so used; or*
>
> *(iii) the interest of an owner of goods leased for a term of one year or more; or*
>
> *(iv) the interest of an owner of goods delivered under a consignment.*

C. The Purchase-money Security Interest in Inventory

Section 34 (2) of the Model Act provides:

> Subject to sections 30 and 31, a purchase-money security interest in inventory or its proceeds has priority over any other security interest in the same collateral,

(a) if the purchase-money security interest was perfected at the time the debtor received possession of the collateral; and

(b) if any secured party, whose security interest was actually known to the holder of the purchase-money security interest or who, prior to the registration by the holder of the purchase-money security interest, had registered a financing statement covering the same items or type of inventory, had received notification of the purchase-money security interest before the debtor received possession of the collateral covered by the purchase-money security interest; and

(c) if such notification states that the person giving notice had, or expected to acquire, a purchase-money security interest in inventory of the debtor, describing such inventory by item or type.

Provided, however, that a security interest in proceeds shall not havepriority over a security interest in accounts given for new value where afinancing statement relating thereto has been registered before the purchase-money security in inventory was perfected or a financing statement relating thereto was registered.

All the various drafts based on Article 9 contain a provision such as this giving a special priority to the purchase-money security interest in inventory; but different versions have taken very different views as to how this special priortty ought to operate.

The most persistently discussed question arising out of this provision has been what the priorities would be in the following situation. *A* makes an advance to a debtor, obtains a security interest in "existing and future accounts receivable," *B* then sells a batch of inventory to the debtor on credit, obtains a purchase-money security interest under section 34 (2), and complies with all the requirements of that subsection. The debtor now sells some of the inventory on credit, so that the debtor has rights in an account. Which of *A* and *B* has priority to the account?

Under the 1962 version of Article 9 and the Catzman Committee Report the answer was quite unclear. Under the Model and Uniform Acts, and the 1972 version of Article 9, the answer is clearly in favour of the accounts financer. The Ontario Act and Ontario Commission Report favour the inventory financer.

The point is a difficult one of policy, but our preference is for the inventory financer who claims the account as proceeds. The account has been generated only because the inventory financer enabled the debtor to acquire the piece of inventory which generated the account. It is therefore our view that the inventory financer ought to be given a more powerful claim to follow the account than the accounts financer.

It could be argued that the accounts financer has also injected new funds into the debtor∗s pool of assets and this, too, should be taken into account in determining relative priorities. This is true, but *ex hypothesi* the accounts financer has not geared his advance and security interest to particular items of new inventory. Our conclusion is therefore in favour of the proceeds of inventory interest. This result would be achieved by omitting the proviso from section 34 (2) of the Model Act.

Another point relates to the existence of knowledge of a security interest in section 34 (2) *(b)*. In order to obtain purchase-money status, the inventory financer must provide notification to the holder of any known security interest covering the same items or type of inventory. This is so even if the security interest in question is not registered. But what happens if the inventory financer fails to give that notice? As long as he registers, he still defeats the conflicting interest under the general priority rules contained in section 35 (1). The only situation where this would not be true is one in which the conflicting interest is itself perfected, but by a method other than registration. If, however, the inventory interest satisfied section 34 (2) *(a)* by registering in time, the conflicting interest could not be perfected by taking possession of the goods so as to defeat the purchase-money interest under the general priority rules and it is difficult to envisage circumstances in which the conflicting security interest could be temporarily perfected. We therefore favour removing the reference to knowledge from section 34 (2) *(b)* since it serves no practical function. The 1972 version of Article 9 has taken the same step.

In paragraph *(a)* of section 34 (2), we would change the word "collateral" to "inventory," so as to remove the possibility of an argument that, in a claim to proceeds, registration was in time if it took place before the proceeds reached the debtor's possession.

Section 34 (2) *(b)* requires the purchase-money secured party to give notice of his interest to others who have registered a financing statement, if the latter registered before the purchase-money secured party registers. In some circumstances, however, the purchase-money secured party may be temporarily perfected without having to register. It is not clear, on present drafting, whether the temporarily perfected interest can enjoy purchase-money priority without notifying previously registered secured parties. The kind of situation where this problem is likely to arise is in connection with the temporary release, under 26 (2), of goods held by a bailee on behalf of the purchase-money secured party or documents of title in the possession of the purchase-money secured party.

The solution to this problem adopted in the 1972 version of Article 9 is to require that the purchase-money secured party give notice to previously registered secured parties prior to the beginning of the period of temporary perfection. The Commission also favours this solution.

The Commission recommends:

Section 34 (2) of the Act be modified so as to read:

"Subject to sections 30 and 3], a purchase-money security interest in inventory or its proceeds has priority over any other security interest in the same collateral,

(a) if the purchase-money security interest was perfected at the time the debtor received possession of the inventory; and

(b) if the purchase-money secured party gives notification in writing to the holder of the conflicting security interest, if the holder had registered a financing statement covering the same items or types of inventory,

(i) before the date of registration by the purchase-money secured party, or

(ii) before the beginning of the ten day period when the purchase-money security interest is temporarily perfected without registration or possession under section 26 (2); and

(c) if such notification states that the person giving the notice had acquired, or expected to acquire, a purchase-money security interest in inventory of the debtor, describing such inventory by item or type."

D. The Purchase-money Security Interest in Collateral Other Than Inventory

Purchase-money security interests in inventory are regulated by subsection (2) of section 34. Subsection (3) relates to all other forms of such interests. It provides:

(3) A purchase-money security interest in collateral or its proceeds, other than inventory, has priority over any other security interest in the same collateral if the purchase-money security interest was perfected at the time the debtor obtained possession of the collateral or within ten days thereafter.

The differences in treatment are apparent. The noninventory interest is not surrounded by the same kind of formal requirements. The three major points of difference, it will be seen, relate to notification, the scope of the proceeds interest, and the time of perfection. The last matter is considered in the next section of this chapter.

The absence of a notification requirement, in the case of the noninventory interest, arises from the fact that the continuous flow of finance from financer to debtor is unlikely to be immediately affected by the purchase of new equipment, whereas in inventory financing the purchase of new items of inventory collateral will be instantly reflected in an inventory financer's willingness to advance more credit. In the case of equipment financing there is, therefore, no need to see that everyone is immediately informed of the creation of a purchase-money interest.

The differences in the Model Act's treatment of the purchase-money status of proceeds in the case of inventory and noninventory financing are based on the fact that in noninventory, say equipment, financing an interest in receivables will not normally arise since early sale of the collateral will not be contemplated. There is, therefore, no reason why the proceeds interest in equipment financing should not cover any such account that arose out of, for example, an instant resale by the debtor. This is not the kind of transaction on which accounts financing is based.

E. The Purchase-money Security Interest and Grace Periods

Sections 22 (2) and 34 (3) both relate to the priority of certain purchase-money security interests and provide for grace periods of 10 days. Thus, where certain kinds of purchase-money security interests are competing with certain kinds of other interests, the purchase-money secu-

rity interest may be registered up to 10 days after the debtor obtains possession of the collateral without the secured party forfeiting his special purchase-money status. Section 22 (2) provides:

> A purchase-money security interest that is registered before or within ten days after the debtor∗s possession of the collateral commences has priority over
>
> *(a)* an interest set out in subclause (ii) or (iii) of clause (a) of subsection (1); and
>
> *(b)* the interest of a transferee under a transfer in bulk or otherwise not in the ordinary course of business of the transferor, occurring between attachment and registration of the security interest.

The interests referred to in paragraph *(a)* are those of "a person... (ii) who assumes control of the collateral through legal process, or (iii) who represents the creditors of the debtor as assignee for the benefit of creditors, trustee in bankruptcy, or receiver."

We agree with paragraph *(a)*. In general, an execution creditor or representative of the creditors will defeat an unperfected security interest. The concession made to the purchase-money interest in section 22 (2) *(a)* runs counter to this principle, but for justifiable reasons. The real reason for allowing the unsecured creditor to defeat the unperfected secured creditor is not so much that the unsecured creditors may have given credit in ignorance of security interests that are unperfected. This argument would not prove strong enough to justify the principle since it would only catch security interests in existence at the time of granting unsecured credit, whereas in fact that principle is quite general in application. The point is rather that the priority enjoyed by a security interest is a privilege. To take advantage of it, the secured party should behave according to prescribed procedure, and this involves registration or possession of the collateral. Such an attitude may not be wholly rational, but it is one very firmly embedded in our whole law of secured transactions.

The departure from that principle on behalf of the purchase-money secured party is a small one. First the narrow definition of purchase-money interests must be borne in mind. The secured party can only claim back what he gave. Secondly, he must have given it not more than 10 days before he registered. This means that the indulgence granted to the purchase-money interest is no more than the time the mechanics of the transaction would normally take. It scarcely empowers the unperfected secured party, who sees that all is not well with his debtor, to take steps to rectify his earlier recklessness by a well-timed act of registration. The provision is, therefore, likely to cause little hardship or unfairness to unsecured creditors.

Paragraph *(b)* of section 22 (2) relates to transactions outside the ordinary course of business, such as bulk transfers. The reasons for giving special protection to a purchase-money security interest are the same in this case as in the case of execution creditors and assignees for the benefit of creditors.

The other provision concerning grace periods in purchase-money transactions is section 34 (3), which relates to purchase-money security interests in collateral other than inventory and was discussed in general terms in the previous section of this chapter. The justification for the grace period in this case is that the normal instance of a noninventory purchase-money interest

will be a security interest in equipment and certain consumer goods. There is, in such cases, no expectation of an early disposition of the collateral. Consequently, it seems reasonable to give the secured party 10 days within which to register. We would not recommend any change in this.

CHAPTER XII THE PRIORITY SYSTEM: FUTURE ADVANCES

The problem of priority arising in the context of future advances has generated considerable literature in the United States. The basic provision in the Model Act which relates to future advances is section 15, which reads:

> A security agreement may secure future advances or other value whether or not the advances or other value are given pursuant to commitment.

The difficulty is to determine who has priority in the following type of situation. *S* obtains a security interest from *D* on January 1. On that date *S* advances $1,000 and perfects his security interest. On February 1 *X*, a judgment creditor, obtains control of the collateral by legal process; or *Y* obtains a security interest in the collateral which he immediately perfects; or *Z* purchases the collateral out of the ordinary course of business. So far, it is clear that, as to the advance of $1,000, *S* has priority over *X*, *Y*, and *Z*. If, however, *S* makes a further advance of $1,000 as part of the same general financing arrangement as his original advance, does he have priority over *X*, *Y,* and *Z* as to this second $1,000 also? Does the answer depend on whether *S* was contractually obliged to make the second advance under the terms of the security agreement with *D?* Is it relevant whether or not *S* knew about *X*, *Y*, and *Z* at the time he made the second advance?

The Model Act has no special rules applicable to those problems and they are therefore subject to the general priority rules of section 35 (in the case of *Y*, the competing security interest); or section 22 (1) *(a)* (ii) (in the case of *X*, the judgment creditor who has assumed control of the collateral); or section 22 (1) *(b)* (in the case of *Z*, the nonordinary course buyer). The outcome depends upon whether *S*∗*s* security interest was perfected on January 1 for the purposes of the advance made on March 1, or whether it is not perfected until the future advance was actually made on March 1. The 1962 Draft of Article 9 provided no clear answer, and the Model Act perpetuates the ambiguity.

The 1972 Draft of Article 9 has introduced new provisions for resolving these problems. In the case of two conflicting security interests, section 9-312 (7) provides:

> If future advances are made while a security interest is perfected by filing or the taking of possession, the security interest has the same priority for the purposes of [the general priority rules] with respect to the future advances as it does with respect to the first advance. If a commitment is made before or while the security interest is so perfected, the security interest has the same priority with respect to advances made pursuant thereto. In other cases a perfected security interest has priority from the date the advance is made.

The idea of this provision is that the date on which public notice is given (by registration or by taking possession) shall be the date which establishes a party∗s priority in respect of all the advances he makes. We agree with this principle and recommend no addition to the Model Act to deal specifically with this point since the effect of recommended changes in the general priority rules would be *ipso facto* to produce the desired result.

There is also the problem of the intervening judgment creditor. The effect of section 22 (1) of the Model Act is that a judgment creditor, who assumes control through legal process of collateral subject to an unperfected security interest, defeats that security interest. The problem of future advances arises when the secured party had a perfected security interest in certain collateral, but he makes a further advance on the security of that same collateral after the judgment creditor has assumed control of the collateral. This problem is left unresolved by the 1972 amendments to the general priority rules of Article 9, since those amendments only relate to priority conflicts between two security interests, whereas this is a problem of a conflict between a security interest and nonsecurity interest.

Article 9-301 (4), however, provides:

> A person who becomes a lien creditor while a security interest is perfected takes subject to the security interest only to the extent that it secures advances made before he becomes a lien creditor or within 45 days thereafter or made without knowledge of the lien or pursuant to a commitment entered into without knowedge of the lien.

The secured party's right to priority as to the future advance made within 45 days of the lien is geared to United States tax law. The American federal tax lien's priority, as against a security interest, is tied, in part, to the priority of a lien creditor as against such an interest. Subject to eliminating that aspect of the provision, we favour the principle contained in it and would adopt it in modified form.

The Commission recommends:

Section 22 of the Act be modified by adding, as subsection (3), the following:

"A person who assumes control of collateral through legal process takes free of a security interest to the extent that it secures advances made after the secured party acquires knowledge that the person has assumed control or is made more than 42 days after the person assumes control, whichever first occurs, unless the advances are made pursuant to a commitment entered into before the expiration of the 42-day period and without knowledge of the assumption of control."

The third aspect of the problem, that of the intervening nonordinary course buyer, is resolved by Article 9 in section 9-307 (3), which provides:

> A buyer other than a buyer in ordinary course of business... takes free of a security interest to the extent that it secures future advances made after the second party acquires knowledge of the purchase, or more than 45 days after the purchase, whichever first occurs, unless made

pursuant to a commitment entered into without knowledge of the purchase and before the expiration of the 45 day period.

We agree with the principle underlying this provision.

The Commission recommends:

Section 30 of the Act be modified by adding, as subsection (5), a provision in the same terms as section 9-307 (3) of the 1972 version of Article 9 of the Code, except that references to 45 days should be amended to read "42 days."

The provisions of Article 9 discussed above make use of the term "pursuant to commitment" in connection with the making of future advances. The idea behind this is clear. It refers to the case where the second party is under an obligation, imposed by the security agreement, to make future advances. This term is also to be found in section 15 of the Model Act which permits a security agreement to provide for future advances. It is not, however, defined in the Model Act. The 1972 Draft of Article 9 has introduced a definition. Section 9-105 (1) *(k)* provides:

An advance is made "pursuant to commitment" if at the time it is made the secured party is bound to make it unless the obligation is conditioned on the happening of an event within his control or upon the exercise of his discretion.

We believe that a definition would be useful, but we do not fully understand the impact of the Code definition. As we understand it, the central idea behind "an advance made pursuant to commitment" is that the secured party made an advance and if he had failed to do so he would have been in breach of the security agreement. The difficulty is that it is not enough simply to refer to the terms of the security agreement to see if there is such a commitment. It was held in *West* v. *Williams* [3] that such a commitment may be discharged if the security has become impaired such as by an intervening sale, grant of a security interest, or levying of execution. Thus, whether there is a commitment to make an advance depends on both the terms of the security agreement and the supervening circumstances. To take account of this, we favour a rather different definition.

The Commission recommends:

Section 1 of the Act be modified by adding a definition of "advance pursuant to a commitment" in the following terms:

> *"'advance pursuant to commitment* means an advance where the secured party was required by the security agreement to make the advance and either that requirement remained binding on the secured party at the time he made the advance, or the secured party behaved in a commercially reasonable manner in making the advance."*

CHAPTER XIII THE PRIORITY SYSTEM: CODE AN NONCODE INTERESTS

A. Introduction

Reference has been made to the fact that, besides regulating priority between competing security interests in the same collateral, the Model Act also lays down certain rules for determining priority between a security interest in collateral and a conflicting, nonsecurity interest in the same subject-matter. For convenience, we refer to those interests as code interests and noncode interests respectively. The rules that regulate priority between code and non-code interests are by no means complete and many matters are left for the general law. In this chapter we discuss such rules as the Model Act provides and consider their modification.

B. Unperfected Security Interests

Section 22 (1) *(b)* of the Model Act gives priority over an unperfected security interest to "the interest of a transferee who is not a secured party to the extent that he gives value without knowledge of the security interest and before it is perfected..." We are unsure of the meaning of "to the extent that he gives value" in this context. In other contexts the expression "to the extent that he gives new value" is used. If the phrase used in section 22 (1) *(b)* is to take its basic meaning from the meaning in other contexts of the Act, except that the "value" need not be "new," the result would appear to be that the transferee in section 22 (1) *(b)* only defeats the unperfected security interests in so far as the price he paid is equal to or more than the market price of the collateral. If he paid less than the market price, the implication might be that the transferee did not get the benefit of the difference between the market price and the price the transferee paid, but rather would be subordinated to the unperfected security interest to that extent. We would, therefore, prefer to use the words "the interest of a transferee who . . . gives value" rather than "the interest of a transferee . . . to the extent that he gives value."

The Commission recommends:

Section 22 (1) (b) of the Act be modified by deleting the words "to the extent that he" and substituting "and."

We have already recorded our view that the references to chattel paper and to intangibles that are accounts should be removed from section 22 (1) *(b)*.

Section 22 (1) *(a)* (ii) of the Model Act provides:

> 22. (1) Except as provided in subsection (2), an unperfected security interest is subordinate to
> (a) the interest of a person,
> (ii) who assumes control of the collateral through legal process.

The purpose of this provision is to give preference to an execution creditor over a secured creditor in relation to items of collateral as to which the security interest is unperfected. The issue is, when does personal property come under the control of execution creditors under the various forms of execution? An examination of the case law relating to priority conflicts between execution creditors on the one hand and unperfected conditional sellers, mortgagees, floating chargees, and assignees of accounts on the other, reveals only that the law is in a state of

chaos and uncertainty. The relevant statutory provisions are usually conceived in such simplistic terms that they totally fail to contemplate the complexity of the situations that may arise.

In our view, little can be done until there is an overhaul of the law relating to enforcement and execution. It would, of course, be possible to go through the various forms of execution and try to define a point at which the execution creditor∗s rights should prevail over those of unperfected secured creditors, but this would not really meet the problem, since it has other aspects that would not be accounted for simply by identifying the moment of crystallization of the various execution processes. The problem is not likely to be solved until all the various forms of execution are co-ordinated into a single mould, with a consistent conceptual structure and terminology. This possibility is one which we hope to pursue in the context of our project on the enforcement of judgments.

The only workable solution in the meantime is to hand the problem over to the judges. Section 22 should, however, clearly convey the idea that there is some point in time at which an execution creditor∗s general rights have so far crystallized against specific property that it would thereafter be wrong for the unperfected secured creditor to defeat the execution creditor. Section 22 (1) *(a)* (ii) could be amended to express this idea more forcefully than it now does.

The Commission recommends:
Section 22 (1) (a) (ii) be modified by substituting the following:
"...whose rights to collateral have, through legal process, so far crystallized that it would be inequitable to permit the secured party to defeat them."

C. Noncode Liens

Section 32 of the Model Act relates to priority between code interests and liens in respect of the supply of services or materials. The Model and Uniform Acts are quite similar to another on this point, although they contain one significant difference in their treatment of nonpossessory liens such as garagemen's liens arising under the *Mechanics∗ Lien Act.* The Ontario Act and the Reports of the Ontario Law Reform Commission and the Catzman Committee, although similar to one another, differ substantially from the Model and Uniform Acts. To facilitate comparison, we set out the relevant provisions of the Model and Uniform Acts and the Ontario Act.

Section 32 of the Model Act provides:

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

Section 32 of the Uniform Act provides:

(1) Where a person in the ordinary course of business furnishes materials or services with respect to goods in his possession that are subject to a security interest, any lien that he has in respect of the materi-

als or services has priority over a perfected security interest uness the lien is given by an Act that provides that the lien does not have such priority.

(2) Where a person in the ordinary course of business furnishes materials or services with respect to goods not in his possession that are subject to a security interest, any lien that he has under any Act in respect of the materials or services has such priority over a perfected security interest as is given by that Act.

Section 32 of the Ontario Act provides:

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

It will be seen that the Ontario Act does not extend to nonpossessory liens, and hence does not deal with the priority of nonpossessory garagemen 's liens. The Uniform Act provides for both possessory[3] and nonpossessory liens, although it gives less priority strength to the latter than to the former. The Model Act encompasses both possessory and nonpossessory liens and gives both the same priority strength as against Code interests. The Commission prefers the treatment given by the Model Act.

D. Transfers in the Ordinary Course of Business

Section 30 (1) and (2) relates to transfers, in the ordinary course of business, of goods that are subject to a security interest, whether perfected or unperfected. A transfer in the ordinary course of business to a transferee who does not know that the transfer is a breach of the security agreement defeats the security interest. We are in agreement with this provision and have no suggestions for amendment.

E. Security Interests in Consumer Goods

The problems which Article 9 and its offspring were intended to overcome manifest themselves most severely in the area of commercial financing. It is not unnatural, therefore, that such legislation was designed to accommodate the realities and complexities of modern commercial financing. Moreover, the Article 9 approach presupposes that those who come in contact with the system will be able to accommodate their practices to it with relative ease.

One can assume a certain level of sophistication in those who trade in, or lend money secured by an interest in, collateral. There are, however, two classes of persons with respect to whom such an assumption cannot be safely made. One is the consumer debtor. He is the buyer of consumer goods from a dealer in such goods who grants a purchase-money security interest in those goods, or who borrows money on the security of his consumer goods. The other such person is the private buyer of those goods from the consumer debtor.

The impact of the Act on the consumer debtor is a topic which we have chosen to characterize as "consumer protection" and explore in a separate chapter of this Report. The position of the private buyer is considered below.

The realities of consumer financing are also relevant to the registration of security interests in collateral, which is consumer goods. In practice, under existing law, large numbers of such agreements go unregistered for reasons set out below. This suggests that a re-examination of the registration requirement is desirable in this context.

In all versions of Article 9, limited recognition is given to a principle that a distinction may be drawn between security interests in consumer goods and secured commercial transactions. The Model Act provides a specific definition of "consumer goods."

"consumer goods" means goods that are used or acquired for the use primarily for personal, family or household purposes.

That definition will relate to, for example, the following provisions:

13. (2) No security interest attaches under an after-acquired property clause in a security agreement.
(b) *to consumer goods,* other than accessions, unless the debtor acquires rights in them within ten days after the secured party gives value.

16. *Except as to consumer goods,*[7] an agreement by a debtor not to assert against an assignee any claim or defence that he has against his seller or lessor is enforceable by the assignee who takes the assignment for value, in good faith and without notice, except as to such defences as may be asserted against the holder in due course of a negotiable instrument under the *Bills of Exchange Act* (Canada).

Those exceptions to the Act which relate to the position of the consumer debtor are consumer protection legislation. We raise them at this point only to illustrate that to draw a distinction between consumer transactions and commercial transactions is no novelty and does not do significant violence to the concept of the Act.

So far as registration and its effects are concerned, none of the Canadian versions of Article 9, or existing personal property legislation in force in this Province, draws such a distinction. Essentially, the position of the private buyer of consumer goods under the Act is comparable to the position of all buyers under existing legislation—the buyer takes subject to a security interest which may be registered, unless the seller is a trader and section 30 (1) is applicable. We must consider whether this accords with the realities of the "marketplace" (assuming one can apply that term to private sales).

1. THE BUYER'S EXPECTATIONS

Is a registration scheme compatible with private sales of consumer goods? Does a registration scheme impose a search requirement on the buyer which is unduly burdensome or puts him needlessly at peril? What are the expectations of the public in this area? The answers seem to turn on the nature of the goods. It is relatively widely known that a buyer of high-priced goods, particularly motor-vehicles, should undertake a search of some sort. On the other hand, a person who contemplated answering a private classified ad offering for sale a refrigerator or a radio would be very surprised if told that he must conduct a central registry search to fully

protect himself. In the vast majority of cases such searches are *not* made and we see little prospect of that situation changing if new legislation was introduced.

2. THE EXPECTATIONS OF THE SECURED PARTY

Again, the nature and the value of the collateral is relevant. It is our view that a financer will take a security interest in low-value consumer goods for two primary reasons. First, it gives the secured party greater strength in persuading the possibly reluctant debtor to meet the financial obligations which he has undertaken. The coercive effect of a threat to repossess is of significant value to consumer financers. Second, it gives the secured party direct recourse against the goods themselves should collection efforts be unsuccessful.

It is also our view that, again excepting relatively expensive goods, the consumer financer is less concerned with the possibility that third parties may acquire security or proprietory interests in the collateral. We find support for this view in the fact that large numbers of security agreements relating to low-value consumer goods are, in fact, *not* registered under existing legislation. The economic realities are such that, if the collateral does find its way into the hands of buyers or other secured parties, proceedings to recover the collateral are seldom worth while, even if such a right exists by virtue of registration.

Just as the Act recognizes and accommodates the practice which has arisen of treating chattel paper as negotiable, it is arguable that the Act should also sanction existing practices and attitudes concerning private sales of low-value consumer goods which are subject to security interests. This could be accomplished through a relaxation of the registration requirement and a provision that the innocent buyer of such goods always takes free of a perfected security interest.

3. THE ARTICLE 9 APPROACH

The latest draft of Article 9 represents a move in this direction. The 1972 official text contains the following provisions:

> 9-302 (1) A financing statement must be filed to perfect all security interests except the following:
> *(d)* A purchase-money security interest in consumer goods, but filing is required for a motor vehicle required to be registered; and fixture filing is required for priority over conflicting interests in fixtures to the extent provided in section 9-313.
> 9-307 (2) In the case of consumer goods, a buyer takes free of a security interest even though perfected if he buys without knowledge of the security interest for value and for his own personal, family or household purposes unless prior to the purchase the secured party has filed a financing statement covering such goods.

The effect of these provisions is that a purchase-money secured party may obtain an automatically perfected security interest without registration or taking possession of the collateral in consumer goods except motor-vehicles and fixtures. This kind of security interest is not, however, as well protected as well as would be the case if it were registered. It will be de-

feated by an innocent consumer purchaser of the debtor, even though the sale is not in the ordinary course of business.

The policy underlying those provisions seems to be that, if one excludes certain classes of goods such as motor-vehicles, the kinds of collateral involved in these transactions are likely to be relatively low-priced consumer durables and the time and expense involved in registration, even under a notice filing system, might be proportionately high, having regard to the relatively low values of the collateral involved.

We consider, first, the position of the innocent private buyer under the Article 9 scheme. On paper, his position looks attractive, but on closer examination it may be no better than his position, under existing chattel security legislation. The innocent buyer, in order to fully protect himself, is obliged to carry out a search, in every case to guard against a possibility that the secured party may have exercised the option to register which is open to him.

In practice, this difficulty would likely be more potential than real. Under a regime which allows a purchase-money security interest in consumer goods to be perfected without registration it is improbable that large numbers of secured parties would go to the trouble and expense of registration when a buyer from the debtor is the only person whose interests would be affected by that registration. Thus, the buyer∗s exposure to risk would be minimal.

None the less we favour the total elimination of that risk and would fully immunize the innocent private buyer from any such security interest, whether registered or not.

The second issue is more difficult. Should a purchase-money secured party be given a perfected security interest in consumer goods, without registration or possession, by which he obtains priority over subsequent secured parties and judgment creditors; or should compliance with registration requirements be the cost of such priority as it is with respect to other types of goods?

A persuasive argument can be advanced in favour of the former position. First, an underlying purpose of registration is to ensure that potential creditors are not misled as to the debtors means by the appearance of wealth in his possession, but this rationale applies with significantly less force in the context of consumer financing. It seems generally agreed that general creditors and consumer financers do not search chattel security registers to see if the sofa and television are mortgaged, nor do they check to see what consumer items the borrower possesses. Credit worthiness depends much more on credit history and income security. Given that fact, it seems likely that few subsequent creditors will be misled as to the debtor∗s means. It is therefore questionable whether a registration requirement is worth while from the standpoint of practicality, convenience, and expense.

Where the purchase-money interest is registered, the expense of the registration is a cost of credit granting which the debtor pays for as part of the cost of obtaining credit. But

what benefits are gained? What return is there on this item of expenditure incurred by consumer credit buyers?

It might be argued that a registration requirement would ensure that unencumbered consumer goods remain fully available as collateral to secure future credit. For example, under the Article 9 scheme: *A,* whose hobby is woodworking, owns power tools worth $3,000, which are unencumbered. *A* wishes a consumer loan and approaches the financer, *F,* offering the tools as collateral for a loan. *F* may refuse to make the loan on the grounds that such goods may be the subject of a perfected but unregistered security interest which might defeat him, and the existence of which he is unable to ascertain.

While we concede the possibility of such a situation, we do not see it as warranting the imposition of an otherwise unnecessary registration requirement. On the whole, second-hand consumer goods are very poor collateral and the consumer owner is scarcely losing anything by having the prospect of mortgaging them lessened or even taken away. Most nonpurchase-money consumer loans are personal loans. It would probably be an unusual case where the consumer has valuable consumer goods (sufficient to provide adequate collateral) but is not in a position to raise a personal loan. Unemployment or sickness might bring about such a situation, but it is difficult to imagine that the situation envisaged is anything other than rare. It must also be remembered that, if the reason the consumer wishes to obtain credit is to buy more consumer goods, he can always ensure that his consumer seller or mortgagee gets purchase-money priority to those new goods.

In the final analysis we are persuaded that this Article 9 innovation is a desirable one which should be adopted in modified form.

In our opinion such a move would also enhance the efficacy and credibility of the registry system. First, its operation is likely to be improved if the registration of these low-level transactions are kept to a minimum. Moreover, although, in practice, private buyers of such goods seldom carry out an encumbrance search, if, in fact, that were done with respect to every private sale, the registry system might soon break down. It seems bad in principle to endorse a registry scheme which can operate effectively only if a large number of persons affected ignore its existence. By eliminating the need for encumbrance searches in this context the scheme gains credibility.

4. CONCLUSION

That still leaves the problem of differentiating between low-value consumer goods and high-value goods to which the general effects of registration ought properly apply. Any guidelines must necessarily be somewhat arbitrary, but some principles are relevant.

The distinction between high-value and low-value goods should not be made by specifying a dollar amount in the Act. Nothing would introduce uncertainty into the scheme more quickly. Rather, this question should be approached by specifying a list of particular types

of goods which are likely to be of high value. The list should be as short as possible. A long and complex list would defeat the purpose of protecting the private buyer and would likely only create confusion in the public mind. Our list is set out in the recommendation below.

The Commission recommends:

1. Section 25 (2) of the Act be modified so as to provide:

(2) A security interest is not perfected until it is registered, except in the case of a security interest

(a) in collateral in possession of the secured party under section 24;

(b) temporarily perfected in instruments, securities, or negotiable documents of title under section 26; or

(c) perfected in accordance with subsection (3) of this section.

2. The following be added as subsections (3) and (4) of section 25:

"(3) Subject to subsection (4), a purchase-money security interest in consumer goods is perfected automatically immediately upon attachment without the need for compliance with section 24, or subsection (1) of this section, or any other provision of this Act dealing with the perfection of a security interest, except paragraph (a) of section 21.

"(4) The previous subsection does not apply to security interests in consumer goods consisting of

(a) a motor-vehicle, trailer, or mobile home as defined in the Motor-vehicle Act; *or*

(b) fixtures; or

(c) a small vessel required to be licensed under section 108 of the Canada Shipping Act; *or*

(d) an aircraft governed by the Aeronautics Act *(Canada)."*

3. The following be added as subsections (6), (7), and (8) of section 30:

"(6) Subject to subsections (7) and (8), a buyer of goods takes free of a perfected security interest in those goods if he buys without knowledge of the security interest, for value and primarily for his own personal, family, or household purposes, and if the sale is not in the ordinary course of business of the seller.

"(7) Subsection (6) does not apply to a security interest in

(a) a motor-vehicle, trailer, or mobile home as defined in the Motor-vehicle Act; *or*

(b) fixtures; or

(c) a small vessel required to be licensed under section 108 of the Canada Shipping Act; *or*

(d) an aircraft governed by the Aeronautics Act *(Canada).*

"(8) Subsection (6) does not apply if the security interest was perfected by possession of the secured party under section 24 at all material times during the negotiation, formation, and performance of the contract to buy the goods."

CHAPTER XIV THE REGISTRATION SYSTEM

A. Introduction

Sections 41 to 54 of the Model Act create the registration system envisaged in the earlier parts of the Act relating to perfection of a security interest by registration. It is beyond our competence as a law reform body to specify the mechanics of how the registry should operate. That is a task for those who specialize in the analysis and design of business systems. What we have to say about the registration system is, therefore, confined to a consideration of the provisions of the Act from the point of view of its substantive requirements.

B. The Method of Registration

The principal question to be considered in connection with the registration system is what should be contained in the registry and hence available to public inspection? The policies at stake here are not difficult to perceive. On the one hand the system must enable those with a reasonable interest in knowing of security interests against the debtor∗s collateral to discover them. On the other hand, the registration system should not impose such onerous requirements on secured parties and debtors such that the operation of secured financing is unreasonably hindered.

The main alternatives which a revised personal property security system presents are "transaction" filing and "notice" filing. Transaction filing is the type of registration requirement typically required under current Provincial personal property security statutes. The basic principle is that the registry should contain the original security agreement or a copy of it. Under this system of registration, a new document must be registered each time a new security transaction is entered into if the effect of the transaction is that there is now a new security agreement. Notice filing, by contrast, does not require that the actual terms of the security agreement be registered. It requires simply that the identity of a secured party and the type of collateral in which he claims a security interest appear on the registry. Under the principle of notice filing, if someone is interested in obtaining more detailed information as to, for example, the precise items of collateral covered by the security interest or the amount of the indebtedness, he should inquire of the parties themselves. This form of registration has been in operation in Canada since 1923 under section 88 of the Bank Act.

Article 9 of the Code is based on the principle of notice filing rather than transaction filing. Section 9-302 requires that a financing statement be filed in order to perfect security interests in various forms of collateral. Section 9-402 goes on to say what a financing statement is:

(1) A financing statement is sufficient if it gives the names of the debtor and the secured party, is signed by the debtor, gives an address of the secured party from which information concerning the security interest

may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral...

The Model Act offers alternative requirements for registration, the intention being that an enacting province should choose which type of registration requirement it prefers. Section 47 (Alternative A) adopts the principle of notice filing, whereas section 47 (Alternative B) adopts the principle of transaction filing for security interests in collateral other than inventory and accounts, and the principles of notice filing for security interests in inventory and accounts.

The Ontario Act, as originally enacted, required transaction filing for all security interests except security interests in inventory. But the 1973 amendment to the Ontario Act provides for notice filing for security interests in all types of collateral capable of perfection by registration.

The Commission favours the principle of notice filing rather than transaction filing. It can only work effectively, however, if the Act provides an alternative method of discovering information which is not contained in the register, but which various people have a legitimate interest in obtaining. This method is provided in section 20 of the Model Act.

The advantages of notice filing are that it is much simpler to administer than transaction filing, it reduces the difficulties and costs of security interests given for future advances and in respect of after-acquired collateral. Moreover, if, as it seems not unlikely, the Province∗s registration system is computerized, notice filing would simplify the task considerably.

One problem calls for special mention. The registration system we have been discussing assumes that the financing statement will be registered against the name of the debtor.[3] But under the present system of registration, interests against motor-vehicles are accessable only through a search of the serial number of the vehicle. This aspect of the registration system is considered in Chapter XVII.

In addition to our general recommendation in favour of notice filing, we would add that we agree with the Model Act in abolishing all requirements of affidavits of execution and bona fides, and we also agree that a financing statement should be capable of being filed at any time, before or after the execution of the security agreement.

The matters required by section 47 (Alternative A—notice filing) to appear on the financing statement are the signature of the debtor, the name and address of the debtor, the name and address of the secured party, and "a description of the collateral sufficient to enable it to be identified." We agree with these requirements except only that we prefer the statement of the description requirement contained in section 9-402 of the Code: "a statement indicating the types, or describing the items, of collateral." It might be noted that section 47 (2) (Alternative A) provides that a financing statement which has not been signed by the debtor may be registered if it is accompanied by a signed copy of the security agreement.

The Commission recommends:

Alternative A of section 47 of the Act be adopted except that the requirement in relation to the description of the collateral in section 47 (1) (c) should be "a statement indicating the types, or describing the items, of collateral."

C. The Effect of Registration

Under the Model Act, the effect of registration is to perfect a security interest in collateral of the appropriate type. Perfection is a term of art in the Act and its significance lies in the area of priorities. The Act is designed to give a reasonably comprehensive account of priorities involving security interests. The Ontario Act, however, in section 53, provides that "registration of a financing statement constitutes notice of the security interest to which it relates to all persons claiming any interest in such collateral." We are unable to appreciate why this provision was inserted. The Model Act, by contrast, provides, in section 54AA: "Registration of a document shall not constitute constructive notice of its contents to third parties unless otherwise provided in this Act."

The question whether registration of a security interest constitutes constructive notice of that interest to those claiming a conflicting interest has been a matter of great difficulty and controversy under the present law. The clear intention of the Ontario Act is to settle that question by saying that registration is constructive notice. Unfortunately, however, the effect of saying this in the context of the Ontario Act is far from clear since a number of the priority provisions of the Act depend upon there being "knowledge" of the existence of a security interest. If registration means notice, it becomes unclear whether knowledge means registration or actual knowledge. We favour the approach of the Model Act on this question and we see nothing but difficulty in the way of the Ontario approach. Article 9 was intended as a coherent system of priority rules. To introduce doctrines whose implications are unclear tends only to cast doubt on the nature of system that Article 9 sought to create.

At the same time, we feel the drafting of section 54AA could be improved. As presently worded it is confined to negating constructive "notice." Various sections of the Act, however, refer to the "knowledge" of third parties. We are not totally confident that section 54AA would avoid the registration of a document being held to amount to constructive knowledge. The matter should be put beyond doubt.

The Commission recommends:

Section 54AA be replaced by a provision in the following terms:

"*54AA. Registration of a document shall not constitute constructive notice or knowledge of its contents, the security interest to which it refers nor of the document itself to third parties unless otherwise provided in this Act.*

It is also necessary to make special provision for transactions falling within section 31 of the *Sale of Goods Act.* That provision reads:

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

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

(3) Subsection (2) does not apply to goods, the possession of which has been obtained by a buyer under a conditional sale within the meaning of the *Conditional Sales Act,* where the seller has complied with the provisions of the *Conditional Sales Act.*

Section 31 relates to the situations where a seller continues in possession of goods or documents of title despite having sold them [5] or where buyer, or person who agreed to buy, who obtains possession of goods or documents of title.

Transactions falling within these provisions may also be within the provisions of a personal property security Act. A conditional sale under which a buyer obtained possession falls within section 31 (2), and yet it is also a secured transaction. Bills of sale absolute may be within section 31 (1). We have recommended that they should be governed by a personal property security Act. Section 31 (3) of the *Sale of Goods Act* provides that a purchaser from a conditional buyer of goods should not receive the protection that section 31(2) would give him.

The effect of section 31 (3) might be summarized by saying that registration under the *Conditional Sales Act* is notice of the conditional seller∗s interest to buyers, pledgees, and others who acquire rights in goods through the conditional buyer. If a personal property security Act is enacted in this Province, section 31 (3) of the *Sale of Goods Act* should be repealed and replaced by a comparable provision to the effect that transactions falling within the personal property security Act shall not be affected by section 31 of the *Sale of Goods Act.*

The Commission recommends:

Section 31 (3) of the Sale of Goods Act *be repealed and replaced with a provision comparable to the following:*

"Subsection (1) and (2) do not apply to determine the respective rights of parties where the Personal Property Security Act *applies to one or more of the transactions by which those rights are constituted."*

CHAPTER XV RIGHTS, DUTIES, AND REMEDIES

A. Warranties, Acceleration, and Management

Section 17 of the Model Act provides:

Where a seller retains a purchase-money security interest in goods,

(a) the *Sale of Goods Act* governs the sale and any disclaimer, limitation or modification of the seller∗s conditions and warranties; and

(b) except as provided in section 16, the conditions and warranties in a sale agreement shall not be affected by any security agreement.

We agree with this provision.

Section 18 of the Model Act provides that where a secured party has a right under the security agreement to accelerate payment or performance of the debtor∗s obligation if he deems himself insecure, he must exercise that right in good faith. We agree with the policy of this provision but are of the opinion that to the requirement of "good faith" should be added one of "reasonableness."

The Commission recommends:

Section 18 of the Act be modified by adding after the word "impaired" the words "and it is reasonable, in all the circumstances, that payment or performance be accelerated."

Section 19 sets out a code of rights and duties in relation to the management of collateral which is in the possession of a secured party. Subsection (1) requires the secured party to "use reasonable care in the custody and preservation" of such collateral. Subsection (2) makes incidental expenses in connection with the collateral, such as insurance and taxes, chargeable to the debtor; puts the risk of loss or damage caused other than by the secured party∗s negligence on the debtor; permits the secured party to add any produce of the collateral to the security interest or, if the produce is money, to apply it in reduction of the debt; requires the secured party to keep nonfungible collateral identifiable; and permits the secured party to create a security interest out of the collateral as long as this does not impair the debtor∗s right to redeem. Subsection (2) is subject to any contrary agreement between the parties. Subsection (3) provides that, despite liability under subsection (1) or (2), the secured party does not lose his security interest. Subsection (4) prohibits use of the collateral except as authorized by the security agreement or the court or to preserve its value; and subsection (5) gives the debtor remedies for unauthorized use. We agree with those provisions and have no further comment to make on them.

B. Access to Information

Section 20 of the Model Act is an important provision in the operation of the Act∗s registration system. As noted in the previous chapter, section 47, Alternative A, which we have adopted, provides for "notice filing." Under this system, the registry may contain little more information than the name and address of the secured party and a description of the collateral by type or item. A method is therefore required to ensure that persons with a legitimate interest can obtain additional information from the parties themselves. This is the function of section 20.

Subsections (1) and (2) permit the "debtor, execution creditor or other person with a legal or equitable interest in the collateral" to obtain from the secured party information concerning the amount of the indebtedness, the terms of payment, and the collateral subject to the security interest. He may also obtain a copy of the security agreement itself. According to subsections (3) and (4), the secured party must provide the information within 15 days and, if he fails to do so, remedies are provided. A judge may, under subsection (6), extend the time for providing the information, or exempt the secured party from the duty to provide the information if he is not satisfied that the inquirer has a legal or equitable interest in the collateral, or the judge may "make such further or other order as is reasonable and just." Subsection (7) permits the secured party to impose a nominal charge for supplying the information.

We agree with section 20 in principle, but suggest a number of changes might be made. We are concerned that the definition of persons with a legitimate interest in obtaining information concerning a security interest, being confined to persons with a "legal or equitable interest" in the collateral, is too narrow. The point here is similar to the one we discussed in connection with one of the requirements for attachment of a security interest in section 12 (1), that "the debtor has rights in the collateral." When goods are hired the debtor may have neither "rights in the collateral," nor a "legal or equitable interest in the collateral." It is clear, however, that the policy of section 20 requires that the debtor always be one of the persons with a legitimate interest in obtaining information. The phrase "legal or equitable interest in collateral" appears in subsections (1) and (6) *(a)* of section 20. In both instances, we would prefer to substitute the phrase "a legal or equitable interest in, or to the use of, the collateral."

In addition, we believe that creditors generally should be treated as having a legitimate interest in discovering the extent of a secured party∗s security interest, whereas, under the present drafting of the Act, a creditor must be an "execution creditor" before he acquires a legitimate interest. In some circumstances this point might be of considerable importance. In principle, a creditor should be entitled to find out whether there are other creditors likely to rank in priority to him. Without this information he may find it difficult to make a rational decision as to whether his debtor is worth suing. Yet, under the present drafting of the Act, the creditor is in effect told that he must sue and proceed to levy execution before such information becomes available. Thus, we would prefer to see the term "creditor," without qualification, appear in the list of persons contained in subsections (1) and (6) of section 20 who have a legitimate interest in obtaining information as to the extent of the secured party∗s interest.

We should also like to add a feature to the administrative machinery established by section 20. Part, and perhaps the major part, of the operation of section 20 will take place when a debtor wishes to grant a security interest in return for an advance, but he has already granted a security interest to a different secured party and the latter has registered his security interest. The new secured party will obviously be concerned about the scope and extent of the earlier security interest. The new secured party does not fall within the statutory class of persons having a legitimate interest in obtaining information as to the existing security interest, and we should not favour a provision allowing a person the right of access to such information merely on the

strength of a claim that he might possibly become a secured party at some time in the future. But we believe that in those circumstances the debtor should have the right to require the information to be sent direct to the possible new secured party, or, indeed, to anyone else that the debtor wishes to have access to that information. We would therefore modify section 20 (1) accordingly.

Section 20 of the Model Act does not provide for any penalty against a secured party who fails to give the information that he is required to give. It is true that he is liable in damages under section 20 (3) *(a)* for "any direct loss or damage caused thereby," but this is small comfort where decisions are held up pending the obtaining of security interest information. The other remedy the Act provides is a judicial one. A judge is empowered under section 20 (3) *(b)* to require that a secured party gives the information he should have given under the provisions of section 20.

We have considered whether the secured party should not also face a more serious penalty, such as losing his security interest, for failure to give the information he is supposed to give. This would be too harsh a sanction to impose for every breach of a secured party's duty to supply information. The breach might not have been the secured party∗s fault, or it might have been a merely technical breach that caused no prejudice to anyone, or a prejudice that can be adequately compensated for by an award of damages. We believe, however, that there should be a weapon of last resort available to the court to declare a security interest void if in the circumstances the court believes it would be just to do so. There should also be a power to reinstate a security interest that has been declared void, although with loss of priority to intervening interests. The purpose of this loss of priority would not be to penalize the secured party still further but to ensure that the original avoidance of the security interest was only ordered for substantial cause and to prevent intervening interests that relied on the avoidance from being defeated if the interest was reinstated.

The Commission recommends:

Section 20 of the Act be modified as follows:

1. By adding the words "or to the use of" after the words "equitable interest in" where they appear in subsection (1) and (6) (a):

2. By deleting the word "execution" from subsection (1):

3. By adding the words "or that he is a creditor" after the word "collateral" in subsection (6) (a):

4. By adding immediately before paragraph (a) of subsection (1) the following words: "or, if the request is made by the debtor, at any address required by the debtor":

5. By deleting the words "to him" from subsection (1):

6. By substituting the words "comply with" for "reply to" in subsection(3):

7. By adding, as subsections (8), (9), and (JO) the following:

"(8) Where the secured party has failed to comply with the requirements of subsections (1) and (2) and no exemption or extension has been ordered under subsection (6), the debtor, creditor, or other person with a legal or equitable interest in or to the use of the collateral, may

apply to have the secured party∗s security interest, or any part thereof, declared void, and if in all the circumstances, and having regard to the prejudice suffered by any of the above-named parties, this is an appropriate remedy, the judge shall declare the security interest or any part thereof void.

"(9) Where a security interest, or any part thereof, has been declared void, the person who, but for such declaration, would have been a secured party may apply to have the security interest reinstated and the judge may, if satisfied that it would be appropriate to do so, order the security interest to be reinstated.

"(10) Where a security interest or any part thereof is ordered to be reinstated, priority in that security interest shall be determined by the latest of the following events:

(a) The date on which the reinstatement is ordered.

(b) The date on which the security interest is registered:

(c) The date on which the secured party acquires possession of the collateral."

C. Delivery of Agreement

Section 11 of the Model Act provides:

The secured party shall deliver a copy of the security agreement to the debtor within ten days after the execution thereof, and, if he fails to do so after a request by the debtor, a judge may on summary application by the debtor make an order for the delivery of such a copy to the debtor and may make such order as to costs as he deems just.

This is clearly a sensible provision and we agree with it. It is our view, however, that it could usefully be supplemented by a set of provisions comparable to those which we have recommended be added as subsections (8), (9), and (10) of section 20 for failing to provide information.

The Commission recommends:

Section 11 of the Act be modified to provide:

11. (1) The secured party shall deliver a copy of the security agreement to the debtor within ten days after the execution thereof.

(2) Where the secured party fails to comply with subsection (1) after a request to do so by the debtor, a judge may on summary application by the debtor make an order for the delivery of such a copy to the debtor and may make such order as to costs as he deems just.

(3) Where the secured party has failed to comply with an order made under subsection (2), the debtor may apply to have the secured party∗s security interest, or any part thereof, declared void, and if in all the circumstances, and having regard to the prejudice suffered by any of the above-named parties, this is an appropriate remedy, the judge shall declare the security interest or any part thereof void.

(4) Where a security interest, or any part thereof, has been declared void, the person who, but for such declaration would have been a secured party, may apply to have the security interest reinstated and the judge may, if satisfied that it would be appropriate to do so, order the security interest to be reinstated.

(5) Where a security interest or any part thereof is ordered to be reinstated, priority in that security interest shall be determined by the latest of the following events:

(a) The date on which the reinstatement is ordered:

(b) The date on which the security interest is registered:

(c) The date on which the secured party acquires possession of the collateral.

D. Remedies

Part V of the Model Act sets out a code of remedies available to the secured party and the debtor. We have very little comment to make about the Act∗s code of remedies. Most of them are familiar and exist under present law. There is little to be gained from paraphrasing the various provisions, and the reader is simply referred to Appendix A for the substance of the code. We do, however, wish to draw attention to two matters.

Section 61 (1) of the Model Act creates a new type of right for the debtor under a security agreement. It allows a defaulting debtor to reinstate the security agreement by paying off overdue arrears plus the secured party∗s expenses, or to redeem the collateral by fulfilling all his obligations under the security agreement. This privilege does not, however, extend to "corporate securities" as defined in the Act. The Commission agrees with the inclusion of this provision.

It will be recalled that section 2 of the Model Act provides that assignments of accounts and chattel paper not intended as security are deemed to create security interests for the purposes of the Act. Section 55 (1), however, provides that that inclusion shall not extend to the Act∗s code of remedies. We have recommended that certain absolute bills of sale where the seller remains in possession of goods and leases of goods "for a term of one year or more" and consignments should be included within the Act even though not intended as security. It is our belief that these nonsecurity transactions should also be exempted from the code of remedies contained in Part V of the Model Act.

The Commission recommends:

Section 55 (1) of the Act be modified so as to read:

"55. (1) The rights and remedies referred to in this Part are cumulative. Unless otherwise provided, Part V does not apply to

(a) assignments of accounts or chattel paper not intended as security; or

(b) leases of goods or consignments not intended as security; or

(c) a sale of goods which is not in the ordinary course of business of the seller if the seller remains in possession of the goods after the buyer has a right to possession thereof.

CHAPTER XVI CONSUMER PROTECTION CONSIDERATIONS

A. Introduction

In Chapter XIII it was pointed out that personal property security legislation such as the Model Act is focused on, and designed to accommodate, the realities and complexities of modern commercial financing. It presupposes a financer and debtor of roughly equal bargaining strength and business acumen.

A large part of modern secured financing does not, however, fit that pattern. We are speaking of what are broadly referred to as consumer transactions. Here the debtor is not a business man but an ordinary individual who may give a security interest in his goods or other personal property which he owns. The debtor may buy, for personal use, an automobile on time by a conditional sale agreement. He may borrow money from a consumer finance company and grant a chattel mortgage as security. In this context it is illogical to presuppose equality of bargaining strength and business acumen.

It is widely recognized that the consumer is at a disadvantage when dealing with the professional financer. Thus, various governments have enacted legislation such as the *Consumer Protection Act* and the *Bills of Exchange (Amendment) Act*[2] aimed at modifying the position of the consumer debtor. In terms of legal analysis, "consumer protection" laws operate to create exceptions to laws of general application and, in particular, have the usual effect of limiting the freedom of contract of the parties where that so-called freedom inevitably operates to the benefit of the supplier or financer.

Consumer protection laws take various forms, but generally they fall into two categories. The first category includes those laws which involve a substantive departure from laws of general application. They might define certain transactions which may not be entered into at all, such as the sale of a hazardous product,[3] or they may operate to prescribe certain standards or rights and remedies which the parties are not free to vary as they are under the general law. For example, certain consumer protection legislation voids any clause in a contract for the retail sale of new goods which purports to exclude the warranties provided in the *Sale of Goods Act.*[4]

The other category of consumer protection laws does not purport to alter the general law, but makes its application contingent upon compliance with requirements which usually relate to formalities and disclosure. For example, the *Consumer Protection Act* provides:

> 6. (1) An executory contract is not binding on the buyer unless it contains
> *(a)* the name and address of the seller and the buyer;
> *(b)* a description of the goods sufficient to identify them with certainty;
> *(c)* the price of the goods and a detailed statement of the terms of payment;
> *(d)* where credit is extended, a statement of any security for payment under the contract, including the particulars of any negotiable instrument, conditional sale agreement, chattel mortgage, or any other security;
> *(e)* where credit is extended the statement [re cost of borrowing] required to be furnished by section 11 or 12;
> *(f)* any warranty or guarantee applying to the goods and, where there is no warranty or guarantee, a statement to this effect; and
> (g) any other matter required by regulation.

(2) An executory contract is not binding on the buyer and no action against the buyer in respect thereof may be commenced unless

(a) it is signed by the buyer;

(b) if it is a contract to which sections 7 to 10 apply [door to door sales], it contains a notice in the form in the Schedule, with paragraph 4 thereof completed, and the notice is at least as prominent as the other contents of the contract; and

(c) a copy thereof has been received by the buyer by personal delivery mail.

So long as those requirements are met, and subject to other enactments, full freedom of contract prevails.

Legislation of this kind represents an attempt to improve the position of the consumer and achieve what legislators conceive to be an appropriate balance between consumers and the business community. The aim of this chapter is to examine the impact which a personal property security Act of general application would have on that balance and to outline the possible need for complementary legislation.

B. The Impact of the Act

Reference was made in Chapter I to the difficulties and uncertainties which surround existing security devices. The present law makes the creation of certain types of security interest impossible, or at best of uncertain validity. In other instances the creation of a security interest is subject to a degree of formality which makes it impractical in low-value transactions.

In a way, this has worked to the benefit of the consumer. The consumer financer will normally wish to, and is frequently in a position to, require that the debtor give the best security possible. For example, a dealer selling an automobile on credit would, if permitted by existing law, probably like to obtain, in a single agreement, a security interest in

(a) the automobile;

(b) all other goods of the debtor;

(c) the debtor∗s wages;

(d) any other money owing the debtor;

(e) any after-acquired property or accounts and proceeds of *(a), (b), (c),* and *(d).*

It would be impossible for the dealer (or, more realistically, the dealer∗s financer) to obtain such a security interest under the present law. But the Act (without the consumer protection provisions referred to below and in the absence of other relevant legislation) would erase the difficulties now faced by the financer.

There are many who have grave doubts that consumer financers should have such latitude in creating security interests. For example, it can be argued that if the security interest is given to secure purchase-money, that interest should be restricted to the goods sold. That is the implication of section 14 of the Uniform Act which provides:

A purchase-money security interest in consumer goods does not attach to any collateral other than those consumer goods.

It can also be argued that there should be certain types of consumer goods in which it is impossible to obtain an enforceable security interest. These goods might be characterized as basic necessities such as food and clothing. The law has long recognized that it has an interest in seeing that creditors should not deprive debtors of their assets to the extent that socially undesirable consequences arise and the debtor ceases to be a self-supporting unit in our society.

Thus, judgment debtors are given certain exemptions from execution [6] and tenants are given certain exemptions from distress.[7] It requires no great leap to extend this policy to the area of personal property security and develop an exemptions notion.

Similarly, there are the exemptions provided by the *Attachment of Debts Act* [8] with respect to wage garnishment. Why should a creditor be able to obtain a right to a debtor∗s wages through the use of a security device to an extent which would not be permitted were he a judgment creditor? Lest it be thought that a wage assignment given as security for a consumer debt is a rather remote possibility, we point out that the standard form conditional sales agreement employed by a major Vancouver retailer contains the following clause:

> For value received Purchaser(s) hereby absolutely assign(s) transfer(s) and set(s) unto seller all his wages, salary, commissions and all other monies earned or to be earned by him in the employ of his present employer, or any future employers to the extent of the balance outstanding on this transaction. Purchaser hereby authorizes and directs his said employer or any future employer to pay said wages, salary and all other monies due or to become due him to the said assignee and releases his employers and each of them from all liability for so doing. Purchaser constitutes and appoints said assignee his attorney to take all proceedings which may be proper or necessary for the recovery of the amount as above assigned and given receipt for same in his name. The assignment is executed and delivered as security for payment of an account in the amount of the Total Deferred Balance, shown above and allowed to him this day by said assignee.

While an assignment of wages would be expressly excluded from the Act by our recommended section 3 *(e),* the Act would engender a climate favourable to the creation of security interests where that is not now the practice and it might well be found that more and more consumer financers would require wage assignments. In this context it is interesting to note that, apart from certain exceptions set out in section 4, the *Payment of Wages Act* prohibits wage assignments. In 1970 the section 4 exceptions were expanded so as to include and permit an assignment of wages "to meet credit obligations."

Finally, it may be that the remedies provided in the Model Act should be reviewed in the light of consumer protection considerations. We point out that the probable effect of such legislation, without modifications, would be to allow many currently unsecured consumer creditors to enhance their status to that of secured parties. As a result, many new summary and self-help remedies against goods would become available to replace the remedies of the unsecured creditor which would formerly have been exercisable only through the sheriff. We are unable to ascertain whether this will result in a deterioration of the consumer debtor∗s position, but we sus-

pect that it might. While the Model Act's code of remedies does make some concessions to the special nature of consumer debt, it may be that these are not apt or do not go far enough.

C. Consumer Protection Provisions in the Model Act

The Model Act recognizes that, while provisions of general application are appropriate to define the rights of competing secured parties in the context of consumer transactions, they may require modification with respect to rights as between debtor and secured party. The Model Act, therefore, contains some provisions aimed at improving the position of the consumer debtor.

1. RELATIONSHIP TO OTHER CONSUMER PROTECTION LEGISLATION

Section 68 of the Model Act provides:

Where there is conflict between a provision of this Act and a provision of [*a consumer protection Act*] the provision of [*such Act*] prevails and, where there is conflict between a provision of this Act and a provision of any general or special Act, other than [*a consumer protection Act*] the provision of this Act prevails.

This provision asserts the superiority of consumer protection legislation over the Act if a conflict should arise. We agree with the retention of section 68.

2. AFTER-ACQUIRED PROPERTY

The only provision of the Model Act which limits the parties' freedom of contract and is specifically directed at consumer transactions is section 13 (2) *(b),* which provides:

No security interest attaches under an after-acquired property clause in a security agreement.
(b) to consumer goods, other than accessions, unless the debtor acquires rights in them within ten days after the secured party gives value.

"Consumer goods" are defined in section 2 *(e)*:

"consumer goods" means goods that are used or acquired for use primarily for personal, family, or household purposes;

No other provision in the Model Act places substantive limitations on the sort of security interest which a consumer financer may take. Section 13 (2) *(b)* would not appear to prohibit

- *(a)* the "all goods" mortgage;
- *(b)* the acquisition of a security interest in after-acquired accounts, including wages;
- *(c)* the acquisition of a security interest in
  - (i) proceeds of consumer goods/collateral under a proceeds clause in the security agreement unless the proceeds are themselves consumer goods; or

(ii) a section 27 proceeds interest whether or not the proceeds are consumer goods

Section 13 (2) *(b)* thus represents only a minimal step in the direction of insulating the consumer debtor from the ease with which security interests may now be created under the Model Act.

D. Policy Considerations

It appears to us that the balance between the interests of consumers and of the business community referred to in the introduction to this chapter would not be restored by section 13 (2) *(b)*. It is also apparent that the balance itself is currently under review by the Provincial Government. The creation of the new Department of Consumer Services and the recent introduction of the *Trade Practices* is ample evidence of this.

If it is concluded that the personal property security legislation which we recommend should not apply to consumer debtors in exactly the same fashion as it applies to commercial debt, the question arises as to who should undertake the task of defining its application to consumer debt. There seem to be two options. It could be done by this Commission in the context of this highly technical study, the focus of which is commercial financing; or it could be done by the Department of Consumer Services in the context of its own policies relating to the consumer interest.

To us the proper choice is obvious. The exceptions in favour of consumer transactions which should be developed must be rationally integrated with other consumer protection policies and legislation. In our view, the only proper body to do so is the Department of Consumer Services. We have a further reason for favouring this approach. We earlier expressed our opinion that a new personal property security Act should be a neutral document. It follows that we would prefer to see complementary consumer protection legislation enacted in a separate Act. The development of such legislation by the Department of Consumer Services would rationalize this division.

In this chapter, therefore, we content ourselves with making recommendations of a general nature.

The Commission recommends:

1. The omission of paragraph (b) of section 13 (2).

2. The Department of Consumer Services develop legislation to replace section 13 (2) (b) which is complementary to the Act and compatible with existing consumer protection legislation and policies.

3. The legislation developed under the previous recommendation should not form part of a personal property security Act but be enacted as part of an Act of a consumer protection character.

CHAPTER XVII TRANSITION

A. The Legislation Replaced

Under present British Columbia law, the *Assignment of Book Accounts Act,* the *Bills of Sale Act,* and the *Conditional Sales Act* are the basic Acts which regulate secured transactions. This Report is based on the proposition that they should be repealed and the proposed personal property security Act (hereafter referred to as the PPSA) should replace them. At the general level of principle and policy, this is the most substantial change required by the enactment of the PPSA. But it cannot be done simply by repealing those three statutes with effect from the day the PPSA comes into force. There are several difficulties. These arise partly because some of the provisions of the *Bills of Sale Act* and the *Conditional Sales Act* should be retained, such as those which incorporate the seize-or-sue principle, and partly because under all three Acts certain transitional provisions are necessary to move from the old system to the new system. The seize-or-sue provisions are the subject of separate comment below.

The need for a transition to the PPSA arises because many transactions registered under an existing Act would simply go into limbo if there were nothing to continue the effect of their registration under the PPSA once the existing Act is repealed. An initial transitional matter, therefore, is to provide that a registration under an existing Act shall be treated as a registration under the PPSA. This means that if a registration of, say, an assignment of book accounts is made in accordance with the requirements of section 7 of the *Assignment of Book Accounts Act,* when that Act is repealed and the PPSA comes into force, there must be a provision which says that the registration under section 7 of the repealed Act shall henceforth be treated as a registration under the PPSA.

It is not sufficient, however, to provide simply that, as from the date of coming into force of the PPSA a registration under an existing Act shall be treated as a registration under the PPSA. The first problem is caused by the differing registration requirements under an existing Act and under PPSA. The existing Acts require transaction, or document, filing (i.e., the document embodying the transaction has to be registered), whereas the PPSA requires notice filing (i.e., certain facts concerning the transaction have to be registered).

There are three possible approaches to this problem. First, the requirements of the PPSA might be relaxed for those transactions which were entered into before the PPSA came into force and which were registered under an appropriate Act. This would be a messy solution although the difficulties created would be short-term, since eventually all the pre-PPSA assignments would be paid or repaid, or abandoned. In the meantime, however, there would be sets of documents which might need to be kept for some time and which formed an active part of the register, and yet which must be processed differently than the notice filing documents. This could be particularly troublesome if the registration system were to run with the aid of sophisti-

cated mechanical or electronic devices that required a uniform pattern of information for storage and retrieval purposes.

At the end of three years a PPSA registration requires renewal. Presumably a registration carried forward from an existing Act would also require renewal if a requirement of renewal is presently imposed. But not all registrations under existing legislation require renewal. For example, all registrations of assignments of accounts and of security agreements under which the debtor is a corporation (except to the extent that the collateral is a motor-vehicle) seem to remain good without renewal. Unless a renewal requirement is imposed, such security interests may remain perfected for an indefinite period of time.

Moreover, what does renewal mean when applied to such a registration? Does it mean renewal in accordance with the requirements of the present legislation or according to PPSA form? If it is the former, then the "messiness" of two different systems of registration could continue for years. If it is the latter, then every secured party who still claims under a pre-PPSA assignment at a time three years after the coming into force of the PPSA must be required to change the documentation in the hands of the Registrar. This would not, however, be an unduly burdensome requirement. It would involve the registration of a financing statement in accordance with section 47 (2), under which the debtor need not have signed the financing statement, provided that the original security agreement was signed by him.

A second solution to the problem of differing registration requirements is to provide that, at the moment of coming into force of the PPSA, a registration under an existing Act will be carried forward as a registration under the PPSA if, but only if, it conforms to the registration requirements of the PPSA. This solution would remove the "messiness" of the first solution, but it would mean a flurry of activity by secured parties, their advisers, and registry officials, as everyone rushed to conform in the days approaching PPSA implementation. Further, even if there were a campaign to publicize "implementation day," it would not reach everyone. Some people would be caught out, in any view, unfairly. This second solution is not very different in principle from the version of the first solution set out in the last three sentences of the previous paragraph. The difference is that, under the second solution, the date on which full conformity to PPSA registration provisions is required is advanced by three years. One would expect that, during those three years allowed by the first solution, the majority of security agreements registered under an existing Act would simply have expired by payment, or repayment, or a renewal would have taken place. Thus, the rush to the registry would be avoided under the first solution. On the other hand, the second solution has the advantage that there would be one system, the PPSA system, of registration in operation from "implementation day" forward, instead of operating two systems for three years as the first solution would require.

The third solution is that adopted in Ontario. This requires the enactment of transitional provisions in the existing Acts. In Ontario, amendments were made to the three principal Acts which contained the following features:

(1) The imposition of renewal requirements on a uniform basis consistent with the renewal requirements of the PPSA.
(2) The imposition of a requirement to provide information consistent with that required for the registration of documents under the PPSA.
(3) The repeal of the principal Act at the appropriate time.

The purpose of these provisions is to marry the registration requirements of the principal Acts to those of the PPSA so that at the time the PPSA comes into force much of the practice under the prior law is consistent with it. This method can only work completely (without having to fall back on either the first or the second solution in addition) if there is at least a three-year time gap between the date on which the amendments to the principal Acts take effect and the date on which the PPSA comes into force. The need for three years of lead time has not caused any problem, as it happens, in view of the delays encountered in preparing the registration system in Ontario.

We are inclined to prefer the "Ontario solution" to this aspect of the transition question. While it pre-supposes a delay of at least three years before the PPSA comes fully into force, it appears that some delay in implementation will be inevitable. It seems the most sensible course to take the fullest advantage of this delay by using it to minimize transition difficulties.

In the context of the British Columbia legislation, adoption of the Ontario approach would require:

(1) the amendment of the three principal Acts to require that all applications to the Registrar-General for registration or renewal be accompanied by a statement setting out that information required by section 47 of the PPSA for the registration of a financing statement;
(2) the amendment of the *Assignment of Book Accounts Act* to impose a requirement that all past and future registrations with the Registrar-General be renewed every three years;
(3) a provision for the repeal of the three principal Acts at the appropriate time.

The rationalization of the registration and renewal requirements of the existing Acts sets the stage for the operation of section 65 of the Model Act. It provides:

Every security interest that was covered by an unexpired filing or registration under the *Assignment of Book Debts Act,* the *Bills of Sale and Chattel Mortgages Act,* and the *Conditional Sales Act* when this section came into force shall be deemed to have been registered and perfected under this Act and, subject to this Act, such registration continues the effect of the prior filing or registration for the unexpired portion of the filing or registration period.

This provision has an administrative effect only. It is designed to carry forward the pre-PPSA registration into the PPSA era, but without changing the consequences and effect of registration under the pre-PPSA legislation.

In terms of policy, section 65 is correct as far as it goes. It is our view, however, that the present drafting of section 65 leaves a large number of questions unanswered. For example, there are certain security interests, and nonsecurity transactions we would deem to be security interests, which under present law have the priority of a perfected security interest without the need to comply with any existing registration requirement. In this category are consignments, security leases, and long-term nonsecurity leases. It is undesirable that pre-existing security agreements should be allowed to remain unregistered (under the Act) indefinitely, but section 65 provides no machinery for bringing them within the Act. Similarly, there may be prior security interests which could have been, but were not, perfected under prior law. What is their relationship to the Act? May they be perfected under the Act when it comes into force? It is our view that section 65 should provide guidance on these and a number of other questions, and a much more detailed provision is necessary.

The Commission recommends:

Section 65 be replaced by a provision in the following terms:

"65.—(1) In this section

(a) 'prior security interest∗ means a transaction, lease, assignment, sale, or consignment validly created or entered into before this section came into force, which is a security interest within the meaning of this Act and to which this Act would have applied if it had been in force at the time the transaction, lease, assignment, sale, or consignment was created or entered into;

(b) 'prior registration law∗ means the Assignment of Book Accounts Act, *the* Bills of Sale Act, *the* Conditional Sales Act, *sections 73 to 82 of the* Companies Act, *and any Act which incorporates, by reference, sections 73 to 82 of the* Companies Act *as part of that Act.*

"(2) A prior security interest that, when this section came into force, was covered by an unexpired filing or registration under a prior registration law shall be deemed to have been registered under this Act and, subject to this Act, such registration continues the effect of the prior filing or registration for the unexpired portion of the filing or registration period, and the effect of the prior filing or registration may be further continued by the registration of a renewal statement under this Act.

"(3) A prior Security interest validly created, reserved, or provided for under any prior law which gave that interest the priority of a perfected security interest without filing or registration under any prior registration law and without the secured party∗s taking possession of the collateral is perfected within the meaning of this Act as of the date the security interest attached, and that perfection continues for three years from the date this section came into force without registration under this Act, after which it becomes unperfected unless renewed or otherwise perfected under this Act.

"(4) The perfection of a prior Security interest that, when this section came into force, was covered by an unexpired filing or registration under a prior registration law, and for the perfection of which under this Act no registration of a financing statement is required, continues under this Act.

"(5) A prior security interest that, when this section came into force, could have been, but was not, covered by a filing or registration under a prior registration law, may, subject to this Act, be perfected by the registration of a financing statement under this Act.

"(6) A prior security interest that, when this section came into force, could have been, but was not, perfected under the prior law by the secured party∗s taking possession of the collateral, may if permitted by this Act be perfected by such possession in accordance with this Act.

"(7) A prior security interest that, under this Act, may be perfected by the secured party∗s taking possession of the collateral is perfected for the purposes of this Act by such possession, whether such possession occurred before or after this section came into force and notwithstanding that the prior law did not permit the perfection of the security interest by such possession.

"(8) A prior security interest that, when this section came into force, could have been, but was not, covered by a filing or registration under a prior registration law and which, under this Act, may be perfected without registration of a financing statement and without the secured party∗s taking possession of the collateral, is perfected for the purposes of this Act by the coming into force of this section, provided all the other conditions for the perfection of a security interest are satisfied.

"(9) The time limit in subsection (3) does not apply to a corporate security."

Assuming that prior security interests can be carried forward and integrated into the Act in an appropriate fashion, a second problem relating to transition emerges. It concerns the effect to be given to a security interest created or perfected under a prior law, which is carried forward as a registered or perfected interest under the PPSA. Once the substantive portion of the PPSA comes into force, how much, if any, of it should apply to a security perfected under prior law?

This problem is of considerable difficulty, particularly when it is remembered that a pre-PPSA security agreement might provide for a security interest in both present and future collateral, and the future collateral may be in part acquired before the coming into force of the PPSA and in part thereafter. Such an agreement might also provide for future advances, some of which are made before, and some after, the PPSA comes into force. It may be possible to say with respect to some matters (for example, contract rights and remedies *inter partes*) that if the security agreement was entered into before PPSA "implementation day," the pre-PPSA rights and remedies should continue to operate even after implementation day, but as to other matters (possibly priorities) that, even though the security interest was granted and registration occurred before implementation day, none the less, after implementation day priorities would be governed by the PPSA. It is obvious that these problems are not easy and it may be that they are actually incapable of solution.

The approach of the Ontario Act and of the Model Act seems to be that the PPSA should apply in a limited fashion only to security interests in existence at the time it comes into force. Section 64 of the Ontario Act provides:

This Act applies only where the security interest attaches on or after the day on which this section comes into force, and, where the security interest attached before this section comes into force, the security interest continues to have such force and effect as if this Act had not been passed.

Thus, the day of attachment is the crucial event determining whether the PPSA applies. The Model Act takes the day of entering into the security agreement and provides a special rule for competitions between pre-PPSA security interests and the PPSA security interests. Section 64 of the Model Act provides:

(1) Transactions validly entered into before this section comes into force and the rights, duties and interests flowing from them remain valid and binding thereafter and may be terminated, completed, consummated or enforced as required or permitted by any statute or other law repealed or modified by this Act as though such repeal or modification had not occurred.

(2) The order of priorities between a security interest validly created under any prior law and a security interest validly created under this Act shall be determined by the prior law.

Both of these approaches seem to raise as many problems as they solve. What does the Ontario provision mean when applied to a pre-existing security agreement which may provide for future advances and attachment to after-acquired property? How far, if at all, does section 64 of the Model Act exclude the application of those sections which provide for the rights, duties, and remedies of secured parties and debtors?

We also see a more serious objection to the approaches of the Model Act and the Ontario Act. In both cases some part of the prior law (just how much is uncertain) will be preserved many years into the future. For example, a chattel mortgage, given as security which is collateral to a mortgage of real property will (if properly renewed) remain effective for the life of the real property mortgage—possibly 30 years or more. We have grave reservations about preserving the existing law, with all its defects and undesirable aspects, for such a period of time, even with respect to security interests created under the existing law.

The approach of the Model Act (and the Ontario Act) reflects, no doubt, a conscious policy decision on the part of those who drafted it to avoid giving the Act retroactive effect. This is a commendable policy in the abstract, but it is not one of universal application. It must be applied with common sense and in a way which does not defeat the purposes of the legislation introduced. Much of the earlier part of this Report was devoted to an exploration of the unsatisfactory aspects of the existing law. While a complete break with the past is impossible outside the context of a full codification of commercial law, in our view the introduction of the PPSA should at least fully eliminate those unsatisfactory aspects. This will not be achieved through a transition provision which preserves much of this existing law, even in a limited way. It follows that, as a matter of principle, we feel the PPSA, when it comes into full force, should apply to all aspects of all security agreements in force at that time. The real question is whether this can be done without significant injury to parties who have acquired rights in reliance on the prior law.

There are two different aspects to this question. The first relates to rights as between the parties to a security agreement and third parties (priority), while the second relates to rights and

remedies of the debtor and secured party *inter se.* From a priority point of view, the Model Act carries forward the policies which are implicit in the existing law. But it does so with extreme care and thoroughness, and retroactive application of the Act is not, therefore, as drastic a step as it might first seem. We have examined a large number of hypothetical fact situations to determine the effect of retroactive application, and in the vast majority of cases the priority position of pre-PPSA security interests is unaffected by the application of the Act. The few hypothetical cases in which a pre-PPSA secured party loses priority are not particularly troublesome. The first category of such cases involves the enhanced position of the innocent bona fide purchaser of goods. Under sections 30 (6) and 49 (1) that purchaser will, in certain circumstances, take the goods free of a perfected security interest where, under prior law, he would take subject to it. In our opinion this result is amply justified on policy grounds set out earlier in this Report, and its retroactive application does not disturb us.

The second category of cases in which a loss of priority may occur through the retroactive application of the PPSA involves situations in which that priority was achieved through what might be called a "loop-hole" in the existing law. For example, at present a chattel mortgage which purports to charge goods to be acquired in the future does not create a legal interest in those goods. Thus, the prior mortgagee may be defeated by a later legal mortgage of those goods given by the debtor once they have been acquired. Under the PPSA the earlier mortgage would have priority. Similarly, a security assignment of a specific debt (a transaction which is not within the *Assignment of Book Accounts Act)* will defeat an earlier registered general assignment of accounts, provided the later assignee gave notice to the debtor in accordance with the rule in *Dearle* v. *Hall.* Under the PPSA the earlier general assignment would have priority.

We are satisfied that any loss of priority arising under the second category would be confined to rare and anomalous situations. It is our understanding that there is no identifiable body of financers who rely on the "loop-holes," and such transactions are so far outside the mainstream of a contemporary secured financing practice that they do not provide a foundation for any serious argument against the retroactive application of the PPSA. Such anomalies are a small price to pay for the benefits which would flow from the full application of the Act.

Full application of the PPSA to prior security agreements will certainly have the effect of making them subject to the rights, duties, and remedies imposed by the Act. Those rights, duties, and remedies may in some cases be inconsistent with those available under the prior law, but we are not troubled by this. The provisions of the PPSA which impose them are aimed at striking a fair balance between secured parties and debtors. It is our opinion that, in any conflict between them and any extraordinary feature of the existing law or a provision of an individual security agreement, a fairer result is likely to be achieved if that conflict is resolved in favour of the PPSA.

We are persuaded that significant advantages will flow from the application of the PPSA to all security agreements, whether created before or after the Act comes into force, without visiting unnecessary hardships on financers or debtors.

The Commission recommends:

Section 64 of the Model Act be replaced by a provision in the following terms:

"This Act applies to every prior security interest, as defined in section 65 (1) (a), which has not been validly terminated, completed, consummated, or enforced in accordance with the prior law before this section comes into force."

B. Corporate Debtors

1. INTRODUCTION

The previous section was devoted to the transition issues involved in "carrying forward" security agreements registered with the Registrar-General (Central Registry) under one or more of the three principal Acts. The office of the Registrar-General, however, is not the only registry under Provincial jurisdiction that is charged with recording security interests in personal property. If the debtor under a security agreement is a corporation, registration may be required in the office of the Registrar of Companies, or the Central Registry, or both, depending on the nature of the collateral. The three principal Acts all contain special registration provisions relating to corporate debtors.

Moreover, the three principal Acts are not the only relevant legislation. The *Companies Act* itself, in sections 73 to 82, sets out fairly detailed requirements relating to the registration of mortgages, debentures, and other securities which charge the real and personal property of "companies" as defined in this Act. Those provisions also govern priorities and the consequences of a failure to register, and, to the extent that they encompass security interests in personal property, are not consistent with the Model Act. To summarize, there are two distinct registries in the Province in which security interests in personal property are recorded.

Under the Model Act the possibility of two separate registries is left open. Section 46 (2) provides:

> Corporate securities and documents relating thereto shall be tendered for registration at the.....office.

Certain other provisions also contemplate the possible existence of a separate registry for corporate debt.[5] It might also be noted that the Model Act contemplates the registration of two types of security agreements—"corporate securities" and security agreements which are not "corporate securities." "Corporate security" is defined in section 1 *(ee)* of the Model Act:

> "corporate security" means every security interest in personal property or fixtures created by a corporation and contained
>
> (i) in a trust deed or other writing to secure bonds, debentures or debenture stock of the corporation or of any other corporation; or
>
> (ii) in any bonds, debentures or debenture stock of the corporation as well as in the trust deed or other writing securing the same, or in a trust deed or other instrument securing the bonds, debentures or debenture stock of any other corporation; or
>
> (iii) in any bonds, debentures or debenture stock or any series of bonds or debentures of the corporation not secured by a separate writing;

Apart from the possibility that corporate securities may be filed in a different registry, they have one other distinguishing feature—they do not need to be renewed as is the case with other security agreements.

Should a separate public registry for corporate debt continue to be maintained in British Columbia? In Ontario, not only is a separate registry maintained, but *The Personal Property Security Act* is totally inapplicable.[7]

Unlike the view which seems to prevail in Ontario, we do not feel that security interests created by corporations should be the subject of distinct legislation with different registration requirements and priority implications. The volume of secured financing under which the debtor is a corporation is a powerful argument in favour of uniform treatment.

The position we take necessarily raises questions concerning the way in which corporate debtors are to be brought within the PPSA. Just as the PPSA contemplates the repeal of the three principal registration Acts, it seems fair to say that it also contemplates the repeal or modification of certain relevant sections of the *Companies Act.* It is to that issue we now turn.

The real question seems to be: what approach should be adopted to a modification or repeal which would implement the PPSA? The most obvious options seem to be:

(1) Modify the *Companies Act* provisions so they do not apply to security agreements governed by the PPSA; or
(2) Modify the *Companies Act* provisions so that, in so far as they apply to security agreements to which the PPSA also applies, those provisions do not conflict with the Act.

We explored these possibilities at length, but in each case the results seemed unsatisfactory.

This led us to consider a more radical alternative which was endorsed by a number of lawyers having extensive experience in company law whom we consulted. It was their suggestion that the mortgage registration provisions in the *Companies Act* be entirely repealed. This necessarily entails a broader examination of those provisions.

2. AN EVALUATION OF THE CORPORATE CHARGE REGISTRY

It has long been a feature of British Columbia companies legislation that certain encumbrances on company assets should be registered in the office of the Registrar of Companies. The existing registration requirements set out m the *Companies Act* [8] are the modern counterpart of provisions introduced in 1906 which in turn were based on English legislation enacted in 1900. At the time of their introduction there was a need for a registry of the sort established. Chattel security registration was on a fragmented county or district basis. The Torrens system of land registration had not yet emerged in the form in which we know it today and much privately

owned land was not within the system. Registration systems which existed were not capable of accommodating sophisticated financing transactions. The need for a single encumbrance registry which was accessible and complete was obvious, and registration under the *Companies Act* seemed an appropriate vehicle to create such a facility with respect to corporate debt.

In our view many of the considerations which led to the creation of a charge registry under the *Companies Act* do not retain their force in British Columbia today. The Land Registry system has been perfected for most relevant purposes. Personal property charge registration has been centralized and, with the enactment of a new *Personal Property Security Act,* most defects which might justify a company security registry vanish.

Moreover, the *Companies Act* registration scheme is imperfectly conceived. Earlier in this Report we recorded our belief that a fundamental principle which underlies property registration schemes is that notice should be given when there is a separation of interest and possession. Hence the object of registration should be to prevent persons from being deceived by the appearance of wealth in the hands of the company by giving publicity to the fact that other parties have an interest in that wealth. The scope of the *Companies Act* registration provisions is, however, uncertain. *Prima facie,* they focus only on mortgages and debentures and ignore a multiplicity of other situations in which such publicity is desirable. On the other hand, section 1 of the *Companies Act* defines "mortgage" as including a "secured debt obligation." The latter expression is in turn defined as a "bond, debenture, note, or other similar obligation." What transactions do or do not require registration? For example, if a person reserves title to property through an agreement for sale of land, or a lease or consignment of property, intended as security, to a company, is registration under the *Companies Act* required so that publicity is given to that person's interest even though the company is in possession of the property? Leases and consignments not intended as security will almost certainly be outside the registration requirements. Must security given under section 88 of the *Bank Act* be registered under the *Companies Act?*

It might be argued, however, that, notwithstanding their defects and possible redundancy, the registration provisions should be retained because the Office of the Registrar of Companies forms a convenient single repository for documents, and avoids the necessity of searching a multiplicity of registries. In our view there is little substance to this argument. First, for reasons outlined above, a registry search will not necessarily reveal the true encumbrance picture of a company due to the gaps in the filing requirements. Secondly, the fact that a filing has been made in the Companies Office does not guarantee that the interest in question has been perfected in any other registry which may be relevant, such as the Office of the Registrar of Shipping or the patent registry.

Moreover, a failure to register under the *Companies Act* does not necessarily mean that the priorities provided by that Act will apply. If a registered ship is mortgaged, it seems that the relevant priorities are governed by the *Canada Shipping Act.* If the registration provisions of that Act are complied with, it is questionable whether any significance attaches to a failure to register under the *Companies Act.* Thus a person who searches the Companies Office only may be misled into believing that company property is unencumbered. All of this suggests that a person

who intends to acquire an interest in a company or its property would be well advised to search all relevant registries in any event. We are told by our consultants that this is the practice and it seems there is, in fact, no real "convenience factor" in the maintenance of a registry under the *Companies Act.*

Another argument in favour of retaining the *Companies Act* registry is that it may act as a public registry for interests and transactions which do not fit into existing or proposed registry schemes. There are certain corporate mortgage transactions which are now required to be registered under the *Companies Act,* which might not be registered in any other specific public registry:

(a) A mortgage of an interest in land not under the *Land Registry Act;*

(b) A mortgage of an unregistered interest in land;

(c) A charge by way of pledge or deposit or escrow of an instrument representing what may be an interest in land, such as a timber sale contract;

(d) A charge by way of an assignment of rents or an assignment of money due under an agreement of sale of land (with no express assignment of the estate).

In fact, our consultants say that these charges very seldom appear in the Companies register as individual specific charges but appear only when they are part of a mortgage of many other interests which under the proposal would be registered in a Land Registry Office or the Personal Property Security Registry. From the point of public notice, little would be lost by abolishing the Companies register for these charges.

We are persuaded that the most desirable way in which to modify the *Companies Act* is to repeal sections 73 to 82.

3. THE MECHANICS OF TRANSITION

Before proceeding to a more specific examination of the mechanics of transition, it is necessary to have a clear picture of the existing registration and renewal requirements to which secured corporate debt within the PPSA is subject. The chart on the following page sets out these requirements in an abbreviated fashion.

It should be noted that both the *Bills of Sale Act* and the *Assignment of Book Accounts Act* exclude, in their definition sections, any bill of sale or assignment which is

(k) a mortgage or charge, whether specific or floating, of book accounts or personal chattels created by a corporation, and contained

(i) in a trust deed or other like instrument to secure bonds, debentures, or debenture stock of the corporation; or

(ii) in any bond, debenture, or debenture stock of the corporation, as well as in the trust deed or other like instrument securing the same; or

(iii) in any bond, debenture, or debenture stock or any series of bonds or debentures of the corporation not secured by any trust deed or other like instrument.

This is similar to the definition of "corporate security" in the Model Act.

Secured Corporate Debt Within the Personal Property Security Act

EXISTING REGISTRATION AND RENEWAL REQUIREMENTS

Method of Creation	**Relevant Legislation**	**Type of collateral**	**where Registered**	**Renewal Required**
Chattel mortgages and assignments of accounts contained in a debenture or trust deed	CA, s. 73 BSA, s. 2 (1) (*w*) ABAA, s. 2 (*k*)	M/V, goods, accounts, and any other collateral specified	RC	No.
Chattel mortgages not contained in a debenture or trust deed				

BSA, ss. 9 (2) (*b*), 12
BSA, ss.9 (2) (*a*), 12
BSA, ss. 9 (2) (*b*), 12

M/V
Goods
M/V and goods
RG
RC
RG and RC
Yes.
No.
Yes with
respect to M/V collateral.
Conditional sales

CSA, ss. 5 (2) (*b*), 8
CSA, ss. 5 (2) (*a*), 8
CSA, ss. 5 (2) (*c*), 8

M/V
Goods
M/V and goods
RG
RC
RG and RC
Yes.
No.
Yes with respect to M/V collateral.
Assignments of accounts not contained in a debenture or trust deed
ABAA, s. 8 (2)
Accounts
RC
No.
Leases and consignments in-tended as security
Security interests created in this way are presently unregulated by statute and there are no registration requirements.

KEY

CA—*Companies Act.*	M/V—Motor-vehicles.
ABAA—*Assignment of Book Accounts Act.*	Goods—Other than motor-vehicles.
BSA—*Bills of Sale Act.*	RC—Registrar of Companies.
CSA—*Conditional Sales Act.*	RG—Registrar-General (Central Registry).

In most cases the hiatus caused by this exclusion is filled by section 73 of the *Companies Act***,** which requires the registration of securities such as debentures and trust deeds. Section 73, however, applies only to "companies" as defined in that Act. "Corporation," the term used in the three principal Acts, encompasses a broader range of bodies. Section 25 (1) (7) of the *Interpretation Act* provides:

"corporation" means any incorporated company, association, society, municipality, or body politic and corporate, howsoever and wheresoever incorporated, and includes a corporation sole other than Her Majesty or the Lieutenant-Governor.

Thus, when a "corporation" which is not a "company," such as a society incorporated under the *Societies Act,* creates a chattel mortgage or assignment in an instrument exempted by the definition set out above, there would appear to be no registration requirement whatever.

The existing complexity is obvious and is to be contracted with the regime we envisage under the PPSA where, for registration purposes, no distinction is drawn between corporate and other debtors and among different types of goods, and only a "corporate security" as defined in the Act is exempt from renewal requirements.

Again, the question is, how do we get from here to there? It seems sensible to adopt the principles employed with respect to the transition of non-corporate secured debt under the three principal Acts. First, we would impose on all registrations made with the Registrar of Companies

(a) under one or more of the three principal Acts; and

(b) under section 73 of the *Companies Act* of all documents which are "security agreements" within the meaning of the PPSA,

a requirement that the relevant documentation be accompanied by a financing statement which conforms to section 47 of the Act. Second, we would require that all existing registrations described under *(a)* and *(b)* above, with the exception of "corporate securities" as defined in the PPSA, expire within a stated time unless renewed. Renewal would also require a financing statement. Finally, we would provide for the repeal of sections 73 to 82 of the *Companies Act* at an appropriate time.

It is also desirable that the *Companies Act* (after repeal of sections 73 to 82) contain a provision to preserve prior rights in respect of interests registered under the repealed provisions which do not fall within the PPSA.

It is our view that the necessary legislation to implement these requirements should take the form of amendments to the *Companies Act* only. It follows that the list of Acts set out in section 65, which carries forward previous registrations, should include the *Companies Act.* Our recommendations are set out with greater specificity in the "Summary" section.

4. "CORPORATE SECURITIES"

It will be noted that we would exclude "corporate securities," as defined in the PPSA, from the renewal requirements. This is consistent with the approach of the Model Act which, in section 53 (2), similarly exempts such instruments from renewal.

The policy which underlies this exemption is straightforward. First, corporate securities tend to secure much larger sums of money than those secured by other types of agreement. Thus, the potential for damage through a loss of priority created by a failure to renew is correspondingly greater. This suggests that a measure of caution is required in imposing renewal requirements. Secondly, it is usual for corporate securities to have a much longer life than other types of agreement, and successive renewals become a nuisance for all concerned. Finally, and possibly most important, in many cases the persons who would suffer through a loss of priority arising out of a failure to renew are not in a position to "police" the security agreement and see that the re-

newal requirements are met. For example, the "beneficial" secured party under a trust deed which secures a series of debentures which are sold to the public is the debenture-holder. But he has no control over the "administration" of the security agreement.

A good deal of consideration was given to imposing, at least, a requirement of re-registration on "corporate securities" previously filed under the *Companies Act,* but it was decided, on balance, that the equities were against such a step. But this gives rise to certain difficulties.

One effect of keeping "corporate securities" outside the renewal requirements, with no compulsion to re-register under the PPSA, is that such securities validly created and registered before the repeal of sections 73 to 82 of the *Companies Act* and unregistered securities created by a "noncompany" "corporation" will not be retrieved by a search under the PPSA, even after the transition provisions are spent.

We see two possible ways of ameliorating this "flaw" in the PPSA registration scheme. We understand that information retrieval techniques in the office of the Registrar of Companies are currently under review with a view to their improvement. At some future time it may be possible, as an administrative matter, to retrieve, in a speedy and reliable fashion, references to all registered corporate securities in a form in which they may be transferred to the PPSA registration records. If the technology involved makes such a step possible, we encourage that it be done.

Another possibility is to warn persons who search the PPSA Registry of these potentially valid, but unrecorded, interests. Every certificate issued under section 44 of the Act should prominently set out a warning in appropriate terms.

A similar concern arises with respect to leases and consignments deemed to be perfected without registration under the PPSA for the first three years of its operation. During that period a section 44 certificate should also bear a warning with respect to that possibility.

5. CONSEQUENTIAL MATTERS

The Second Schedule to the *Companies Act* contains certain forms which are related to the provisions which we have recommended be repealed. Those forms should also be repealed.

Section 169 of the *Land Registry Act* provides:

> 169. (1) Where the instrument purporting to create a charge is executed by a corporation, and is required to be registered in the office of the Registrar of Companies under any Act of the Legislature, and does not come within the provisions of subsection (2), then, subject to that Act, the charge shall not be registered under this Act unless the Registrar of Companies has endorsed on the instrument the fact and date of registration in his office.
>
> (2) Where the instrument executed by a corporation creates a charge on land only and is required to be registered in the office of the Registrar of Companies under any other Act of the Legislature, then, subject to any provisions to the contrary contained in such Act, there shall be tendered to the Registrar of the proper Land Registry Of-

fice, at the same time as the application under this Act to register the charge, a true copy of the instrument together with an additional fee of two dollars and fifty cents, two dollars of which fee shall be transmitted to the Registrar of Companies along with the true copy of the instrument after the latter has first been stamped with the date and time when the application was received.

Those registration requirements relate to section 73 of the *Companies Act* and will become redundant upon the repeal of section 73. They can safely be repealed.

Section 92 of the *Companies Act* provides:

92. (1) Where a company redeems a debenture previously issued, unless any express or implied provision to the contrary is contained in the debenture, the articles or any contract entered into by the company, or unless the company has, by a resolution of the members, manifested its intention that the debenture be cancelled, the company has, and shall be deemed always to have had, power to reissue the debenture, either by reissuing the same debenture, or by issuing another debenture in its place, and on such a reissue the person entitled to the debenture has, and shall be deemed always to have had, the same priority as if the debenture has never been redeemed. (2) Where a company redeems a debenture and has the power to reissue that debenture, particulars of that debenture shall be included in the balance sheet of the company.

(3) Where a company has issued or deposited any debenture created by it to secure advances from time to time on current accounts or otherwise, the debenture shall not be deemed to have been redeemed by reason only that any of the advances are repaid, or that the account of the company ceases to be in debit, while the debenture remains so issued or deposited.

(4) The reissue of a debenture, or the issue of another debenture in its place, under this section shall be deemed not to be the issue of a new debenture for the purpose of any provision limiting the amount or number of debentures to be issued.

Two difficulties emerge from that section. First, the scope of its intended application is far from clear. Our consultants advise us that it was intended to apply to the sort of corporate security referred to in section 73 (3) of the *Companies Act,* that is, a series of *pari passu* debentures which are not covered by a trust deed. This aspect of section 92 should be clarified.

The second difficulty is that section 92 appears to create the possibility of overturning the priority rules of the Model Act in so far as a debenture to which the section applies evidences a security interest in personal property. Sections 92 (1) and 92 (3) are designed to provide "cross-over" security and to this extent have the same function. This calls for some explanation. One function of the security interest scheme under the Model Act is to permit a single act of registration to establish a priority in relation to a floating lien. The lien floats in two senses. First, the collateral may fluctuate. Some of it may disappear to be replaced by other items of collateral. This poses the problem of after-acquired property and it raises questions which have been discussed elsewhere in this Report. Secondly, the secured party∗s lien floats in the sense that the debt or other obligation which is secured may itself fluctuate. Thus, the debtor may pay off the original advance, but then subsequently obtain a fresh advance. None the less, the registration precipitated by the first advance is the effective date of priority for most purposes. The floating lien is, therefore, security in respect of both after-acquired property and future advances. Herein lies its "cross-over" nature. Sections 92 (1) and 92 (3) are concerned with the future advance aspect of cross-over security. Section 92 (3) does not itself pose a problem since its net effect is only to treat the debenture as a single debenture securing a single original debt. It says nothing about the priority of that debenture. Thus, if for some reason the debenture were de-registered at

a time when nothing was owed, any subsequent advance by the debenture-holder would be secured by the original debenture (this is the effect of section 92 (3)), but, ignoring for the moment the effect of section 92 (1), the priority of that debenture would be determined by the applicable set of priority rules, such as section 76 of the *Companies Act* or the PPSA when it comes into force. But section 92 (1) appears to take the priority question of a reissued debenture out of an otherwise applicable registration system, and herein lies its danger.

While the priority implications of section 92 (1) are in basic agreement with the policy of the Model Act—that a single registration at the time an initial advance is made will ensure the same priority for subsequent advances— there are certain exceptions to this general rule contained in the Model Act which would not seem to apply if section 92 (1) prevails. The exceptions referred to are in favour of execution creditors and buyers of the collateral and are set out in our version of sections 22 (3) and 30 *(5)* of the Model Act:

> 22. (3) A person who assumes control of collateral through legal process takes free of a security interest to the extent that it secures advances made after the secured party acquires actual knowledge that the person has assumed control or made more than 42 days after the person assumes control, whichever first occurs, unless the advances are made pursuant to a commitment entered into before the expiration of the 42-day period and without knowledge of the assumption of control.
>
> 30. (5) A buyer, other than a buyer in the ordinary course of business, takes free of a security interest to the extent that it secures future advances made after the secured party acquires knowledge of the purchase, or more than 42 days after the purchase, whichever first occurs, unless made pursuant to a commitment entered into without knowledge of the purchase and before the expiration of the 42-day period.

Those provisions were discussed in Chapter XII.

It is our view that any conflict which may arise between priorities under section 92 and priorities under the PPSA should be resolved in favour of the latter. The difficulties described above might be resolved by modifying section 92 (1) of the *Companies Act* so as to provide:

> "(1) Where a company redeems
>
> *(a)* a previously issued single debenture; or
>
> *(b)* one or more previously issued debentures of a series of debentures containing any charge to the benefit of which the debenture-holders of that series are entitled *pan passu,*
>
> and neither *(a)* nor *(b)* is included in a deed creating or defining the security, then, unless any express or implied provision to the contrary 15 contained in the debenture, the articles, or any contract entered into by the company, or unless the company has, by a resolution of the members, manifested its intention that the debenture be cancelled, the company has, and shall be deemed always to have had, power to reissue the debenture, either by reissuing the same debenture, or by issuing another debenture in its place and, subject to subsection 5*,* on such a reissue the person entitled to the debenture has, and shall be deemed always to have had, the same priority as if the debenture had never been redeemed;"

and by adding a new subsection *(5)* to section 92 in the following terms:

"(5) If a debenture to which subsection (1) applies is a security agreement to which the *Personal Property Security Act* also applies, the priority of that debenture shall be determined in accordance with that Act to the extent that the debenture creates a security interest in personal property to which that Act applies."

The anomalous position of the Farm Credit Corporation under the *Bills of Sale Act* should also be examined. The renewal requirements set out in section 12 do not apply to a bill of sale under which the secured party is that Corporation. In principle we are opposed to exemptions of that type, but if the special status of the Corporation represents a matter of Government policy, it must be accommodated. At the very least, a requirement should be imposed that all such outstanding bills of sale taken by the Corporation be re-registered under the PPSA when it comes into force.

C. Serial Number Registration

Where the collateral under a security agreement is a motor-vehicle, a specification of the serial number has long been a description requirement under the *Bills of Sale Act* and the *Conditional Sales Act.*

We understand that, under current Central Registry practice, all security agreements which embrace only motor-vehicles or certain types of equipment are indexed under serial number rather than under the name of the debtor. We are told that this makes a name search impossible. This situation is difficult to reconcile with the indexing mandate set out in the relevant Acts.

The Model Act, however, is based on registration in the name of the debtor. Earlier chapters of this Report explored the extreme difficulties which serial number description requirements create in the realm of inventory financing. Moreover, as far as we are able to ascertain from Central Registry officials, the recording of serial numbers is a fruitful source of errors and misdescription. In our view, the significance of serial numbers is that they provide a permissible way of describing the collateral if the secured party chooses to do so. In short, we do not feel that serial number registration is an alternative to name registration in the PPSA scheme.

If serial number registered charges are carried forward into, and are deemed to be registered under, the PPSA pursuant to section 65, a large number of difficulties will be created. In our view, serial number registration under existing legislation should be abandoned in favour of name registration as the primary means of identifying the security agreement, and all new registrations and renewals should be on a name basis. If this is done three years or more before the PPSA comes into force, the existing registrations will be "cleaned up" to a point where they will be compatible with the PPSA and can safely be deemed to be registered under it. Such a step probably requires no statutory amendment and can be done by an appropriate administrative directive.

D. The Seize-or-sue Principle

In 1972 this Commission submitted its *Report on Deficiency Claims and Repossessions.* In that Report one particular aspect of personal property security was examined. It had emerged from our research that the law, as it existed at that time, led to abuse and injustice. The difficulty perceived was that a secured party who realized on collateral was under no obligation to obtain the best price possible on resale or to act in a commercially reasonable manner. That led to the so-called "sweetheart deal" in which a secured party would repossess goods, sell them to an associate or affiliate for an unrealistically low price, and then sue the debtor for the deficiency.

Our recommendation was that a solution which had been adopted in other provinces also be made the law of British Columbia—the secured party should be permitted to realize on the collateral or to sue for the debt owing, but not both. This we refer to as the "seize-or-sue principle." We also made a number of complementary recommendations, the principal ones providing that

(a) the seize-or-sue principle be confined to a purchase-money security interest in goods sold by retail sale, that term being defined in a manner comparable to a sale of "consumer goods" in the Model Act; and

(b) Where the debtor under a security agreement has paid two-thirds or more of the purchase price, the secured party may not repossess the goods except under a court order and that the court be given a discretion to grant or refuse the order upon terms.

Our recommendations were implemented, in part, in 1973 by amendments to the *Bills of Sale Act* and *Conditional Sales Act.* That legislation did not, however, restrict the seize-or-sue principle to retail sales as we recommended. It extended to all conditional sale agreements and chattel mortgages, although a provision was included which allowed a corporate debtor to waive the protection given by the legislation. The considerations which prompted the Legislature to extend the seize-or-sue principle beyond consumer transactions to all bills of sale and conditional sale agreements are not known to us. It may be that we were remiss in not pointing out with more vigour that the principle was intended to be reform of a consumer protection character.

We do not retreat from the recommendations made in our earlier Report; but if the *Conditional Sales Act* and *Bills of Sale Act* are repealed in accordance with the recommendations made in this Report, it seems appropriate to reconsider the seize-or-sue principle and its enacting legislation in light of the personal property security legislation which we now recommend. It will be noted that a number of the provisions, in that part of the Model Act which relates to rights and remedies, are incompatible with the seize-or-sue principle. For example, section 59 preserves the right to a deficiency claim, section 55 (7) provides that a security interest does not merge with a judgment for the debt, and there is nothing in the Act comparable with the requirement that the secured party obtain a court order for repossession where two-thirds of the purchase price has been paid. If the principle were to be retained as applicable to all transactions secured by an in-

terest in personal property, it is obvious that Part V of the Model Act would have to be greatly modified.

In our view, the code of remedies, in its present form, is to be preferred to the seize-or-sue principle in the context of commercial financing. We would, however, favour its retention with respect to consumer financing. We therefore recommend that the seize-or-sue principle be retained in the separate but complementary consumer protection legislation contemplated by the previous chapter, and reiterate our view that the principle should not continue to extend to commercial financing.

It is also our view that, in the context of consumer financing, the principle might be extended. The recommendations made in our earlier Report focused on the specific security devices of conditional sale agreement and chattel mortgage. The aim of the Model Act is to eliminate artificial distinctions between the security devices which are functionally similar. It would, therefore, be desirable that the complementary legislation, which is developed and preserves the seize-or-sue principle, use the terminology of the Model Act so as to encompass all security interests in consumer goods. The principle would then apply to leases of consumer goods intended as security and to pledges, both of which are, at present, outside the scope of our earlier recommendations and the 1973 legislation.

If the seize-or-sue principle is preserved in complementary legislation, two provisions of the Model Act which are aimed at enhancing the position of the consumer might be eliminated. Section 60 (1) provides:

(1) Where the security agreement secures an indebtedness and the collateral is consumer goods and the debtor has paid at least 60 per cent of the indebtedness secured and has not signed, after default, a statement renouncing or modifying his rights under this Part, the secured party who has taken possession of the collateral shall, within ninety days after taking possession, dispose of or contract to dispose of the collateral under section *58,* and, if he fails to do so, the debtor may proceed under section 62 or in an action for damages or loss sustained.

The preservation of the seize-or-sue principle makes that principle redundant. That is also the case with respect to section 62 (2) *(d),* which provides a minimum penalty when a secured party disposes of consumer goods/collateral otherwise than in accordance with the code of remedies.

E. Summary of Transition Recommendations

1. AN OVERVIEW

The transition scheme which we recommend is not a simple one. This should not be surprising, however, having regard to the nature and complexity of the gap to be bridged.

The general features of our scheme are as follows. First, the following legislation would be introduced:

(1) The *Personal Property Security Act.*

(2) Amendments to the *Assignment of Book Accounts Act,* the *Bills of Sale Act,* and *Conditional Sales Act* which would

(a) require that all registrations and renewals with the Registrar-General be accompanied by a financing statement which conforms to section 47 of the *Personal Property Security Act;*

(b) impose a three-year renewal requirement on registrations of assignments of accounts with the Registrar-General; and

(c) repeal the Acts on a date to be proclaimed.

(3) Amendments to the *Companies Act* which would

(a) require that all registrations and renewals of security agreements to which the *Personal Property Security Act* would apply which are registered with the Registrar of Companies under

(i) section 73 of the *Companies Act,*

(ii) the *Assignment of Book Accounts Act,*

(iii) the *Bills of Sale Act,* and

(iv) the *Conditional Sales Act,*

be accompanied by a financing statement which conforms to section 47;

(b) impose a three-year renewal requirement on all past and future documents within *(a)* with the exception of "corporate securities" as defined in the *Personal Property Security Act;*

(c) repeal sections 73 to 82 on a date to be proclaimed. It is contemplated that different parts of the legislation would be proclaimed in force at various times. The sequence of events which we envisage is as follows:

Phase One

The sections of the *Personal Property Security Act* which provide for certain administrative matters such as the appointment of the Registrar and the establishment of the registry would be proclaimed first. The Registrar would then set about the task of planning a new registry and putting the necessary wheels in motion. He would give priority to preparing any new regulations necessary to implement the amendments to the other Acts and to prescribing the forms of financing statements to be used.

Phase Two

Second, those portions of the other Acts which require the use of a financing statement and which impose a ren&wal requirement, where none now exists, will be proclaimed into force. This second phase will last from three to four years, depending on the exact way in which the added renewal requirements are imposed. During that time the financing statements generated by the amendments will be forwarded to the PPSA registry. At some point during this time the establishment of the registration machinery will be complete and the financing statements can be recorded in the same fashion as if they had been registered under the PPSA. At the end of this

second phase the PPSA registry should contain a financing statement which relates to every outstanding security interest to which the Act applies except

(1) the security interest which formerly did not require registration;

(2) "corporate securities" registered with the Registration of Companies before the beginning of this phase.

Phase Three

The provisions relating to the repeal of the existing legislation would be proclaimed and the *Personal Property Security Act* would be proclaimed into full force. Other provisions relating to transition would also come into force at this time.

2. SPECIFIC RECOMMENDATIONS

1. The *Assignment of Book Accounts Act, Bills of Sale Act,* and *Conditional Sales Act,* all

(a) amended by the addition of a provision in terms similar to the following:

"A[n] [assignment, bill of sale or conditional sale, as the case may be] or any renewal thereof shall not be registered in the office of the Registrar-General on or after [a date to be proclaimed], unless, in addition to the other requirements of this Act, it is accompanied by a financing statement, in prescribed form, which contains and legibly sets forth at least

(a) the full name and address of the [assignor, grantor or buyer], and

(b) the full name and address of the rassignee, grantee, or seller], and

(c) a statement indicating the types, or describing the items of [the applicable collateral], and

(d) such other information including the information referred to in clause *(a)* to *(c)* as may be prescribed by regulation [this might include incorporation particulars of a corporate party]":

(b) be amended by the addition of a provision that provides for their repeal on a date to be proclaimed.

2. The *Assignment of Book Accounts Act* be amended by the addition of a provision similar to the following:

"(1) Every registration made in the office of the Registrar-General under this Act before [a date to be prescribed] expires on the anniversary date of the original registration next after [another, later date to be prescribed], unless a renewal statement in prescribed form is registered before such anniversary date.

"(2) Every registration made under this Act on or after [a date to be prescribed] expires three years after the date of registration, unless a renewal statement in the prescribed form is registered before the three-year period expires.

"(3) The registration of a renewal statement extends the effect of the original registration for three years from the date of registration of the renewal statement, and so on from time to time.

"(4) Where a renewal statement is not registered within the time prescribed by this section, a judge on application may, upon such terms and conditions and with such notice, if any, as he may order, extend the time for registration upon being satisfied that no interest of any other person will be prejudiced by such extension, but, in the event that it later appears that any such registration within the period so extended has prejudiced the rights that any person acquired before the registration, such registration shall be presumed not to have been done in conformity with this Act for the purpose of determining the rights that such person acquired before the registration.

"(5) A copy of an order made under subsection 4 shall for the purposes of registration be attached to the renewal statement to which the order relates."

3. The *Companies Act* be amended

(a) by providing for the repeal of sections 73 to 82B on a date to be proclaimed;

(b) by adding a new section 82A similar to the following:

"82A. No mortgage, bill of sale, assignment of accounts, or conditional sale required to be registered in the office of the Registrar under

(a) section 73;

(b) the *Assignment of Book Accounts Act,*

(c) the *Bills of Sale Act;*

(d) the *Conditional Sales Act;*

which is a security agreement to which the *Personal Property Security Act* would apply if in force, and no renewal thereof shall be registered unless it is accompanied by a financing statement in prescribed form which contains and legibly sets forth at least

(e) the full name and address of the mortgagor, assignor, grantor, or buyer, as the case may be;

(f) the full name and address of the mortgagee, assignee, grantee or seller, as the case may be;

(g) a statement indicating the types or items of property mortgaged, assigned, granted, or sold;

(h) such other information, including the information referred to in clauses *(e)* to (g) as may be prescribed by regulation [e.g., incorporation particulars of corporate parties]";

(c) by adding a new section 82B in terms similar to the following:

"82B. (1) Every registration of a mortgage, bill of sale, assignment of accounts, or conditional sale made in the office of the Registrar under

(a) section 73;

(b) the *Assignment of Book Accounts Act,*

(c) the *Bills of Sale Act;*

(d) the *Conditional Sales Act;*

before [a date to be prescribed] expires on the anniversary date of the orginal registration next after [a later date to be prescribed] unless a renewal statement in prescribed form and the financing statement required under section 82A is registered before that anniversary date.

"(2) Every registration of a mortgage, bill of sale, assignment of accounts, or conditional sale made in the office of the Registrar under

(a) section 73;

(b) the *Assignment of Book Accounts Act;*

(c) the *Bills of Sale Act,*

(d) the *Conditional Sales Act;*

after [a date to be prescribed] expires three years after the date of registration unless a renewal statement in prescribed form and the financing statement required under section 82A is registered before the three-year period expires.

"(3) The registration of a renewal statement extends the effect of the original registration for three years from the date of registration of the renewal statement, and so on from time to time.

"(4) Where a renewal statement is not registered within the time prescribed by this section, a judge on application may, upon such terms and conditions and with such notice if any, as he may order, extend the time for registration upon being satisfied that no interest of any other person will be prejudiced by such extension, but, in the event that it later appears that any such registration within the period so extended has prejudiced the rights that any person acquired before the registration, such registration shall be presumed not to have been done in conformity with this Act for the purpose of determining the rights that such person acquired before the registration.

"(5) A copy of an order made under subsection (4) shall for the purposes of registration be attached to the renewal statement to which the order relates.

"(6) This section does not apply to a 'corporate security∗ as defined in the *Personal Property Security Act*."

(d) by adding a new section 82c in terms similar to the following:

"Subject to the *Personal Property Security Act,* the validity or priority of any mortgage or debenture filed with the Registrar under any provision of this part formerly in force shall be determined in accordance with the law applicable immediately before that provision ceased to be in force."

(e) by repealing section 92 (1) and replacing it with a provision in terms similar to the following:

"Where a company redeems

(a) a previously issued single debenture; or

(b) one or more previously issued debentures of a series of debentures containing any charge to the benefit of which the debenture-holders of that series are entitled *pari passu,*

and neither *(a)* nor *(b)* is included in a deed creating or defining the security, then, unless any express or implied provision to the contrary is contained in the debenture, the articles or any contract entered into by the company, or unless the company has, by a resolution of the members, manifested its intention that the debenture be cancelled, the company has, and shall be deemed always to have had, power to reissue the debenture, either by reissuing the same debenture, or by issuing another debenture in its place, and, subject to subsection (5), on such a reissue the person entitled to the debenture has,

and shall be deemed always to have had, the same priority as if the debenture had never been redeemed."

(f) by adding, as section 92 (5), a provision in terms similar to the following:

"If a debenture to which subsection (1) applies is a security agreement to which the *Personal Pro perty Security Act* also applies, the priority of that debenture shall be determined in accordance with the Act to the extent that the debenture creates a security interest in personal property to which that Act applies."

(g) by repealing Forms *5* and 6 in the Second Schedule.

4. Section 1 2 of the *Bills of Sale Act* be modified so that the Farm Credit Corporation is no longer exempted from the renewal agreement,

or

Re-registration under the *Personal Property Security A Ct* be required of bills of sale under which the grantee is the Farm Credit Corporation.

5. As an administrative matter, all indexing of security agreements under the serial number of the collateral should cease, and in the future all indexing should be the name of the debtor.

6. Section 169 of the *Land Registry Act* should be repealed.

7. The "seize-or-sue" principle contained on the *Conditional Sales Act* and the *Bills of Sale Act* be retained with respect to consumer transactions in complementary consumer protection legislation.

8. The Model Act should be modified

(a) by omitting section 41 (4);

(b) by omitting the words following "registration system" in section 44 (1) *(a);*

(c) by adding a further subsection to section 44 which provides:

"(4) Every certificate issued under clause *(a)* of subsection (1) may contain a warning in such words as may be prescribed by regulation concerning its accuracy.

(d) by omitting section 46 (2) and renumbering the following subsections;

(e) by omitting section 60 (1) and renumbering the following subsections, and omitting the words "In any case other than that mentioned in subsection (1)" where they appear at the beginning of section 60 (2);

(f) by omitting section 62 (2) *(b);*

(g) by replacing section 64 with the following:

"This Act applies to every prior security interest, as defined in section 65 (1) *(a),* which has not been validly terminated, completed, consumated, or enforced in accordance with the prior law before this section came into force."

(h) by replacing section 65 with the following:

"65.—*(* 1) In this section

(a) 'prior security interest∗ means a transaction, lease, assignment, sale, or consignment validly created or entered into before this section came into force,

which is a security interest within the meaning of this Act and to which this Act would have applied if it had been in force at the time the transaction, lease, assignment, sale, or consignment was created or entered into;

(b) ‘prior registration law∗ means the *Assignment of Book Accounts Act,* the *Bills of Sale A ct,* the *Conditional Sales Act,* sections 73 to 82 of the *Companies Act,* and anyAct which incorporates, by reference, sections 73 to 82 of the *Companies Act* as part of that Act.

“(2) A prior security interest that, when this section came into force, was covered by an unexpired filing or registration under a prior registration law shall be deemed to have been registered under this Act and, subject to this Act, such registration continues the effect of the prior filing or registration for the unexpired portion of the filing or registration period, and the effect of the prior filing or registration may be further continued by the registration of a renewal statement under this Act.

“(3) A prior security interest validly created, reserved, or provided for under any prior law which gave that interest the priority of a perfected security interest without filing or registration under any prior registration law and without the secured party∗s taking possession of the collateral is perfected within the meaning of this Act as of the date the security interest attached, and that perfection continues for three years from the date this section came into force without registration under this Act, after which it becomes unperfected unless renewed or otherwise perfected under this Act.

“(4) The perfection of a prior security interest that, when this section came into force, was covered by an unexpired filing or registration under a prior registration law, and for the perfection of which under this Act no registration of a financing statement is required, continues under this Act.

“(5) A prior security interest that, when this section came into force, could have been, but was not, covered by a filing or registration under a prior registration law, may, stlbject to this Act, be perfected by the registration of a financing statement under this Act.

“(6) A prior security interest that, when this section came into force, could have been, but was not, perfected under the prior law by the secured party∗s taking possession of the collateral, may if permitted by this Act be perfected by such possession in accordance with this Act.

“(7) A prior security interest that, under this Act, may be perfected by the secured party∗s taking possession of the collateral is perfected for the purposes of this Act by such possession, whether such possession occurred before or after this section came into force and notwithstanding that the prior law did not permit the perfection of the security interest by such possession.

“(8) A prior security interest that, when this section came into force, could have been, but was not, covered by a filing or registration under a prior registration law and which, under this Act, may be perfected without registration of a financing statement and without the secured party∗s taking possession of the collateral, is per-

fected for the purposes of this Act by the coming into force of this section, provided all the other conditions for the perfection of a security interest are satisfied.

"(9) The time limit in subsection (3) does not apply to a corporate security."

Section 31 (3) of the *Sale of Goods Act* should be repealed and replaced with a provision comparable to the following:

"Subsections (1) and (2) do not apply to determine the respective rights of parties where the *Personal Property Security Act* applies to one or more of the transactions by which those rights are constituted."

The final recommendation was made in Chapter XIV. We reiterate it here for the sake of completeness.

3. OTHER MATTERS

The enactment of the *Personal Property Security Act* will also have an Impact on other legislation currently in force. In some cases amendments may be desirable to eliminate inconsistencies and avoid anomalous situations. As the issues raised in these cases are of much less importance than the broad transition questions addressed in this chapter, we have relegated a discussion of them to an Appendix.

It will also be noted that we have not made recommendations with respect to a number of procedural matters. For example, sections 1 *(o), 54* (4), 62, and 66 all contain blanks which leave open the question of what court should have jurisdiction over matters arising under the Act. This is a question which lies within the realm of court administration and the answers should come from responsible persons within the Attorney-General∗s office. Nor has any recommendation been made with respect to the procedural personnel contemplated by section 45 (5) *et seq*.

Similarly, we have not specified which consumer protection legislation should prevail over the Act under section 68. This is a matter on which the views of the Minister of Consumer Services should be felt.

CHAPTER XVIII CONCLUSION

A. Summary of Recommendations

It is Commission practice, when issuing a final Report to include, in the final chapter, a summary of all recommendations made in the body of the Report. We do not do so in this case for reasons which seem obvious.

Most recommendations relate to modifications of the Model Act and to repeat each, out of context, is not of any great assistance to the reader. Thus, we record only our recommenda-

tions which are of a general nature and incorporate other recommendations by reference to Appendix A and Chapter XVII.

The Commission recommends:

1. The Model Act, as adopted and approved by the Canadian Bar Association, subject to other recommendations made in this Report and set out in Appendix A, be enacted in British Columbia.

2. The Model Act should be enacted and implemented in accordance with the transition recommendations set out in Chapter XVII.

3. The Department of Consumer Services develop legislation to replace section 13 (2) (b) which is complementary to the Act and compatible with existing consumer protection legislation and policies.

4. The legislation developed under the previous recommendation should not form part of a personal property security A ct but be enacted as part of an Act of a consumer protection character.

B. Acknowledgments

This study could not have been completed without efforts of our consultants who have assisted us throughout. We therefore extend our sincerest thanks to Messrs. C. P. Daniels, Q.C., H. C. Cameron, and M. H. Gropper and to Professor R. Cuming for the contribution which they have made. In fairness to them we feel obliged to point out that the final policy decisions are those of the Commission and we do not wish to imply that all our advisors concur in, or were consulted with respect to, all recommendations.

We wish to make special acknowledgment of the very considerable contributions made by two people to this project. Professor Christopher Carr, now of the Faculty of Law, University of Toronto, began his association with this study while Director of Research to the Commission, and has continued to be closely involved with it at all stages since his resignation from our staff. He, together with Arthur L. Close, our Counsel, have worked closely, not only in advising us on the substantive issues involved, but also on the writing of the Report. Mr. Close, in addition, has done an enormous amount of work in guiding us through the complexities of the transitional issues. We wish to record our great indebtedness to both of them. Without their energy and skill, this Report would have taken considerably longer to prepare.

Finally, we must record, in a general way, our recognition of the valuable work done by other bodies, both within and without Canada, who have carried on research into legislation relating to personal property security. The results of that work provided a starting point for us, and without it, the development of legislation such as we recommend would have been beyond our resources.

LEON GETZ, *Chairman*

RONALD C. BRAY
PAUL D. K. FRASER
PETER FRASER
October 27, 1975. ALLEN A. ZYSBLAT

APPENDICES

Introductory Note

APPENDIX A: ANNOTATED MODEL ACT

It is our intent that this Appendix should serve not only to set out the provisions of the Model Act but as a summary of our recommendations which relate to the substance of a new personal property security Act and as an index to our Report.

The provisions of the Model Act are set out in full in an ordinary type face. Lines have been drawn through those parts which we recommend should be modified or omitted. Any words or provisions which we recommend should be added appear in an italic type face.

In most cases where a modification of the Model Act is apparent there will be, to the right, a reference enclosed in parentheses indicating the page of the Report where the corresponding recommendation is made. In many cases we also give a page reference to passages in the text of the Report which discuss certain provisions which are not changed.

Appendix A **Annotated Model Act**

An Act to Reform and Make Uniform the Law Regarding Security Interests in Personal Property and Fixtures

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

Interpretation **1.** In this Act,

(a) "accessions" means goods that are installed in or affixed to other goods;

(aa) "account" means any monetary obligation not evidenced by chattel paper, an instrument, or securities;

(b) omitted.

"advance pursuant to commitment" means an advance where the secured party was required by the security agreement to make the advance and either that requirement remained binding on the secured party at the time he made the advance, or the secured party behaved in a commercially reasonable manner in making the advance; (p. 104)

(c) "chattel paper" means one or more than one writing that evidences both a monetary obligation and a security interest in specific goods;

"chattel paper" means one or more than one writing that evidences both a monetary obligation and a security interest in, or a lease of, specific goods, but chattel paper does not include a charter-party;(p. 84)

(d) "collateral" means property that is subject to a security interest;
"collateral" means property subject to a security interest and includes goods, accounts, instruments, intangibles, chattel paper, documents of title, and securities (p. 43)

(dd) "consignment agreement" means an agreement under which goods are delivered to a consignee for resale or lease by a consignor who in the ordinary course of his business deals in goods of that description and who reserves title in the goods until payment or resale or lease;
"consignment" means a transaction under which
(i) goods are delivered to a consignee for resale or lease by a consignor who in the ordinary course of his business deals in goods of a similar kind; and
(ii) the consignor retains title in the goods until he has been paid there for or until the goods have been resold or leased; (p. 32)

(e) "consumer goods" means goods that are used or acquired for use primarily for personal, family, or household purposes;

(ee) "corporate security" means every security interest in personal property or fixtures created by a corporation and contained
(i) in a trust deed or other writing to secure bonds, debentures, or debenture stock of the corporation or of any other corporation; or
(ii) in any bonds, debentures, or debenture stock of the corporation as well as in the trust deed or other writing securing the same, or in a trust deed or other instrument securing the bonds, debentures, or debenture stock of any other corporation; or
(iii) in any bonds, debentures, or debenture stock or any series of bonds or debentures of the corporation not secured by a separate writing;

(f) "creditor" includes an assignee for the benefit of creditors, a trustee in bankruptcy, a receiver, and an executor, administrator, or committee;

(g) "debtor" means a person who owes payment or other performance of the obligation secured, whether or not he owns or rights in the collateral, and includes an assignor of accounts or chattel paper and an assignee of the debtor∗s interest in the collateral referred to in subsection (1) of section 49, or such one or more of them as the context requires; and where the debtor and the owner of the

collateral are not the same person, the term "debtor" means the owner of the collateral in any provision of the Act dealing with the collateral, the obligor in any provision dealing with the obligation, and may include both when the context so requires;

"debtor" means a person who owes payment or other performance of the obligation secured whether or not he owns or has rights in the collateral, and includes

(i) the consignee under a consignment;

(ii) the lessee under a lease;

(iii) the assignor of an account or chattel paper; and

(iv) the assignee of a debtor∗s interest in collateral,

or such one or more of them as the context requires, and where a debtor is not the owner of the collateral, the term "debtor" means the owner of the collateral in any provision of the Act dealing with collateral and the obligor in any provision dealing with the obligation, and may include both where the context so requires;

(p. 32)

(h) "default" means the failure to pay or otherwise perform the obligation secured when due or the occurrence of any event whereupon under the terms of the security agreement the security becomes enforceable;

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

(j) "equipment" means goods that are not inventory or consumer goods;

(jj) "financing statement" means a document required or permitted to be registered pursuant to section 47 of this Act;

(jjj) "fungibles" with respect to goods or securities means goods or securities of which any unit is, by nature or usage of trade, the equivalent of any other like unit; but goods or securities which are not fungible shall be deemed fungible for the purposes of this Act to the extent that under the security agreement unlike units are treated as equivalents;

(k) "goods" means all chattels personal other than choses in action and money, and includes fixtures and growing crops; and goods are either consumer goods, equipment, or inventory;

(l) "instrument" means a bill, note or cheque within the meaning of the *Bills of Exchange Act* (Canada), or any other writing that evidences a right to the payment of money and is of a type that in the ordinary course of business is transferred by delivery with any necessary endorsement or assignment, but does not include a writing that constitutes part of chattel paper, a document of title, or securities; *(m)* "intangible" means all personal property, including choses in action, that is not goods, chattel paper, documents of title, instruments, or securities;

(n) "inventory" means goods

(i) that are held by a person for sale or lease, or that have been leased; or

(ii) that are to be furnished or have been furnished under a contract of service; or

(iii) that are raw materials, work in process, or materials used or consumed in a business or profession;

(o) "judge" means a judge of a.....court. (p. 150)

(oo) *"lease" means a transaction under which, for value, an owner of goods permits another person to have possession and use of the goods;* (p. 32)

(p) "notify" means to take such steps as are reasonably required to give information to the person to be notified so that

(i) it comes to his attention; or

(ii) it is directed to such person at his customary address or at his place of residence, or at such other place as is designated by him over his signature, and "notification" has a corresponding meaning;

(q) "prescribed" means prescribed by the regulations;

(r) "proceeds" means personal property in any form or fixtures derived directly or indirectly form any dealing with collateral or proceeds therefrom, and includes any payment representing indemnity or compensation for loss of damage to the collateral or proceeds therefrom;

"proceeds" means identifiable or traceable personal property in any form, or fixtures, derived directly or indirectly from any dealing with collateral, or the proceeds therefrom, and includes any payment received by way of damages, insurance, compensation, indemnity, or settlement in respect of loss of, or damage to, the collateral or proceeds therefrom, or any right to such payment, and any payment received by way of total or partial discharge of an intangible, chattel paper, or an instrument; (p. 73)

(s) *"purchase-money security interest" means* a security interest that is

(i) taken or reserved by the seller of the collateral to secure payment of all or part of its price; or

(ii) taken by a person who gives value for the purpose of enabling the debtor to acquire rights in the collateral, if such value is applied to acquire such rights;

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

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

(iii) *the interest of an owner of goods leased for a term of one year or more; or*

(iv) *the interest of an owner of goods delivered under a consignment* . (p. 97)

(ss) "purchase" includes taking by sale, lease, discount, negotiation, mortgage, pledge, lien, or reissue, gift, or any other voluntary transaction creating an interest in property;

(sss) "purchaser" means a person who takes by purchase;

(t) "registrar" means the registrar of personal property security;

(u) "regulations" means the regulations made under this Act;

(v) "secured party" means a person who has a security interest;

(w) "securities" means shares, stock, warrants, bonds, debentures, debenture stock, or the like issued by a corporation or other person, or a partnership, association, or government;

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

(y) "security interest" means and includes

(i) an interest in goods, documents of title, instruments, securities, chattel paper, or intangibles that secures payment or performance of an obligation;

(ii) an interest arising from an assignment of accounts or chattel paper not intended as security, other than an assignment under the *Assignments and Preferences Act*;

"security interest" means

(i) an interest in goods, documents of title, instruments, securities, chattel paper, or intangibles that secures payment or performance of an obligation;

(ii) the interest of an assignee under an assignment of an account or chattel paper, whether or not intended as security;

(iii) the interest of a buyer under a sale of goods which is not in the ordinary course of business of the seller if the seller remains in possession of the goods after the buyer has a right to possession thereof;

(iv) the interest of an owner of goods leased for a term of one year or more;

(v) the interest of an owner of goods delivered under a consignment;

(yy) "specific goods" means goods identified and agreed upon at the time a security agreement in respect of those goods is made; (p. 84)

(z) "value" means any consideration sufficient to support a simple contract, and includes an antecedent debt or liability. (p. 38)

PART I—GENERAL

Application of Act.

2. Subject to section 3, this Act applies

(a) to every security agreement without regard to its form and without regard to the person who has title to the collateral that in substance creates a security interest, including, without limiting the foregoing,

(i) a chattel mortgage, conditional sale, equipment trust, floating charge, pledge, trust deed, or trust receipt; and

(ii) an assignment, lease, or consignment intended as security; and

(b) to every assignment of accounts or chattel paper not intended as security but not to an assignment for the general benefit of creditors to which the Assignments and Preferences Act applies.

Subject to section 3, this Act applies to

(a) every transaction without regard to its form or to the person who owns the collateral that in substance creates or provides for a security interest, including a transaction that is, or is evidenced by, a chattel mortgage, conditional sale, equipment trust, floating charge, pledge, trust deed, or trust receipt;

(b) a lease of goods intended as security or created for a term of one year or more;

(c) an assignment of an account or chattel paper, whether or not intended as security;

(d) a sale of goods which is not in the ordinary course of business of the seller if the seller remains in possession of the goods after the buyer has a right to possession thereof;

(e) a consignment, whether or not intended as security. (p. 31)

Where Act does not

3. This Act does not apply

(a) to a lien given by statute or rule of law, except as provided in

apply. section 32, clause *(b)* of subsection (4) of section 36, and clause

(b) of subsection (2) of section 37;

(b) to a transfer of an interest or claim in or under any contract of annuity or policy of insurance except as provided in section 27;

(c) to a transaction under the *Pawnbrokers Act*.

This Act does not apply to (p. 34)

(a) *a security interest governed by a statute of the Parliament of Canada to the extent that such statute provides for the rights of parties to the transaction creating or providing for the security interest and of third parties affected by the security interest;*

(b) *a lien, charge, or other security interest given by statute, or a lien given by rule of law for the furnishing of goods, services, or materials, except as provided in section 32, paragraph (b) of section 36 (4) and paragraph (b) of section 37 (2);* (p. 33)

(c) *a right of distress;* (p. 33)

(d) *a transaction to which the* Pawnbrokers Act *applies;*

(e) *an assignment of wages, salary, or other compensation owing or to become owing to an employee;*

(f) *a sale of an account or chattel paper as one of the assets of a business being sold;*

(g) *an assignment of an account or chattel paper for the purpose of collection only;*

(h) *an assignment of a right to payment under a contract to an assignee who is to perform the assignor∗s obligations under the contract;*

(i) *an assignment of a single account to an assignee in whole or partial satisfaction of an existing obligation;*

(j) *an assignment between two or more shareholders of a corporation of an amount owing by the corporation to one or more of them;*

(k) *an assignment of an amount owing by a corporation included as part of a transaction for the sale by the creditor to the assignee of one or more shares of the corporation;*

(l) *a transfer of an interest in or claim in or under a contract of annuity or policy of insurance, except in so far as the moneys payable under a policy of insurance are or would be proceeds;*

(m) *a right of set-off;*

(n) *the creation or transfer of an interest in or a lien on real property,*

including a lease, except to the extent that provision is made with respect to fixtures, and the transfer of any right to payment o r rentthat arises in connection with an interest in or lien on real property; (p. 35)

(o) a transfer in whole or in part of a claim to unliquidated damages;

(p) an assignment for the general benefit of creditors made pursuant to legislation of the Parliament of Canada relating to i n s o l-vency.

Errors, Omissions etc.

4. A document to which this Act applies is not invalidated nor is its effect destroyed by reason only of a defect, irregularity, omission, or error therein or in the execution or registration thereof unless the defect, irregularity, omission, or error is shown to have actually misled some person whose interests are affected by the document.

Conflict of laws.

5. — (1) The validity and perfection and the possibility and effect of proper registration of a security interest in intangibles or goods of a type that are normally used in more than one jurisdiction, if such goods are classified as equipment or classified as inventory by reason that they are held for lease or have been leased by the debtor to others, shall (p. 57)

(a) where the chief place of business of the debtor is in....., be governed by this Act; and

(b) where the chief place of business of the debtor is not in be governed by the law, including the conflict of laws rules of the jurisdiction in which the chief place of business is located.

Idem.

(2) If a jurisdiction does not provide, by registration or recording in such jurisdiction, for perfection of a security interest of the kind referred to in clauses *(a)* and *(b)* of subsection (1), the security interest may be perfected by registration in.....**.**

Conflict of laws continued.

6. (1) Where personal property, other than that governed by subsection (1) or (2) of section 5, was already subject to a security interest when it was brought into.....the validity of the security interest in..... is to be determined by the law, including the conflict of laws rules, of the jurisdiction where the property was when the security interest attached. If the parties to the security agreement understood at the time that the security interest attached that the property would be kept in.....and it was brought into.....within 30 days after the security interest attached for

purposes other than transportation through....., then the validity of the security interest in is to be determined by the law of this Province.

Right of revendication.

(2) Where goods brought into.....are subject to the seller∗s right to revendicate or to resume possession of the goods pursuant to Article 1998 of the *Civil Code* of the Province of Quebec, unless the seller registers a financing statement in the prescribed form or repossesses the goods within 20 days after the day on which the goods were brought into....., such right is unenforceable in.....thereafter.

Conflict of laws continued.

7. (1) Subject to section 5, a security interest in property already perfected under the law of the jurisdiction in which the property was when the security interest attached and before being brought into.....continues perfected in..... for 60 days and also thereafter if within the 60-day period it is perfected in.....**.**

Idem.

(2) Subject to section 5 and notwithstanding subsection (1), where the secured party receives notice within the 60-day period mentioned therein that the property has been brought into.....his security interest in the property ceases to be perfected in.....unless it is perfected under this Act before the expiration of fifteen days from the date he receives such notice or before the expiration of such 60-day period, whichever is earlier.

Idem.

(3) A security interest that has ceased to be perfected in.....due to the expiration of the 60-day period may thereafter be perfected in....., but such perfection takes effect from the time of its perfection in.....**.**

Conflict of laws continued.

8. Subject to section 5, where a security interest was not perfected under the law of the jurisdiction in which the property was when the security interest attached and before being brought into....., it may be perfected in.....and such perfection shall take effect as of the time of perfection in.....**.**

PART II—VALIDITY OF SECURITY AGREEMENTS AND RIGHTS OF PARTIES

Effectiveness of security agreement.

9. Except as otherwise provided by this or any other Act, a security agreement is effective according to its terms between the parties to it and with respect to the rights *in rem* created, or provided for therein, third parties.

Subject to the provisions of this Act, and except as provided in any other Act, a security agreement is effective according to its terms both between the parties to it and, with respect to rights in rem *created or provided for it, against third parties.* (p. 49)

Enforceability of security interest.

10. A security interest is not enforceable against a third party *persons other than the debtor* unless (p. 46)

(a) the collateral is in the possession of the secured party; or

(b) the debtor has signed a security agreement that contains a description of the collateral sufficient to enable it to be identified.
the debtor has signed a security agreement indicating the types or describing the items of collateral. (p. 47)

Delivery of copy of agreement.

11. The secured party shall deliver a copy of the security agreement to the debtor within ten days after the execution thereof, and, if he fails to do so after a request by the debtor, a judge may on summary application by the debtor make an order for the delivery of such copy to the debtor and may make such order as to costs as he deems just.

11. *(1) The secured party shall deliver a copy of the security agreement to the debtor within ten days after the execution thereof.*

(2) Where the secured party fails to comply with subsection (1) after a request to do so by the debtor, a judge may on summary application by the debtor make an order for the delivery of such a copy to the debtor and may make such order as to costs as he deems just.

(3) Where the secured party has failed to comply with an order made under subsection (2), the debtor may apply to have the secured party∗s security interest, or any part thereof, declared void, and if in all the circumstances, amid having regard to the prejudice suffered by any of the above-named parties, this is an appropriate remedy, the judge shall declare the security interest or any part thereof void.

(4) Where a security interest, or any part thereof, has been declared void, the person who, but for such declaration would have been a secured party, may apply to have the security interest reinstated amid the judge may, if satisfied that it would be appropriate to do so, order the security interest to be reinstated.

(5) Where a security interest or any part thereof is ordered to be reinstated, priority in that security interest shall be determined by the latest of the following events:

(a) The date on which the reinstatement is ordered:

(b) The date on which the security interest is registered:

(c) The date on which the secured party acquires possession of the collateral. (p. 120)

When security interest attaches.

12. (1) A security interest attaches when

(a) the parties intend it to attach;

(b) value is given; and

(c) the debtor has rights in the collateral.

A security interest attaches when (p. 44)

(a) value is given; and (p. 38)

(b) the debtor has rights in or to the collateral, (p. 44)

unless in all the circumstances it appears that the parties intended the security interest to attach at a later time, in which case the security interest attaches at the time the parties intend it to attach. (p. 38)

Idem. (2) For the purpose of subsection (1), the debtor has no rights in *or to*

(a) crops until they become growing crops;

(b) fish until they are caught;

(c) the young of animals until they are conceived;

(d) oil, gas, or other minerals until they are extracted; or

(e) timber until it is cut.

After-

13. (1) Except as provided in subsection (2), a security agreement may

acquired property, etc.

cover after-acquired property.

(2) No security interest attaches under an after-acquired property clause in a security agreement

(a) to crops that become such more than one year after the security agreement has been executed, except that a security interest in crops that is given in conjunction with a lease, purchase or mortgage of land may, if so agreed, attach to crops to be grown on the land concerned during the term of such lease, purchase, or mortgage; or

(b) to consumer goods, other than accessions, unless the debtor acquires rights in them within ten days after the secured party gives value. (p. 126)

14. Omitted.

Future advances.

15. A security agreement may secure future advances or other value whether or not the advances or other value are given pursuant to commitment. (p. 102)

Agreement not to assert defence against assignee. R.S.C. 1952, c. 15.

16. Except as to consumer goods, an agreement by a debtor not to assert against an assignee any claim or defence that he has against his seller or lessor is enforceable by the assignee who takes the assignment for value, in good faith and without notice, except as to such defences as may be asserted against the holder in due course of a negotiable instrument under the *Bills of Exchange Act* (Canada).

Seller∗s warranties.

17. Where a seller retains a purchase-money security interest in goods,

(a) the *Sale of Goods Act* governs the sale and any disclaimer, limitation, or modification of the seller∗s conditions and warranties; and

(b) except as provided in section 16, the conditions and warranties in a sale agreement shall not be affected by any security agreement. (p. 117)

Provision to accelerate.

18. Subject to subsection (5) of section 58 and to subsection (1) of section 61, where a security agreement provides that the secured party may accelerate payment or performance when he deems himself insecure, such provision shall be construed to mean that he has power to do so only if he in good

faith believes that the prospect of payment or performance is impaired *and it is reasonable, in all the circumstances, that payment or performance be accelerated.* (p.117)

Care of collateral.

19. (1) A secured party shall use reasonable care in the custody and preservation of collateral in his possession, and, unless otherwise agreed, in the case of an instrument or chattel paper, reasonable care includes taking necessary steps to preserve rights against prior parties. (p. 117)

Idem, rights and duties of secured party.

(2) Unless otherwise agreed, where collateral is in the secured party∗s possession,

(a) reasonable expenses, including the cost of insurance and payment of taxes or other charges incurred in the custody and preservation of the collateral, are chargeable to the debtor and are secured by the collateral;

(b) the risk of loss or damage, except where caused by the negligence of the secured party, is on the debtor to the extent of any deficiency in any insurance coverage;

(c) the secured party may hold as additional security any increase or profits, except money, received from the collateral, and money so received, unless remitted to the debtor, shall be applied forthwith upon its receipt in reduction of the secured obligation;

(d) the secured party shall keep the collateral identifiable, but fungible collateral may be commingled; and

(e) the secured party may create a security interest in the collateral upon terms that do not impair the debtor∗s right to redeem it.

Liability for loss.

(3) A secured party is liable for any loss or damage caused by his failure to meet any obligations imposed by subsection (1) or (2), but does not lose his security interest.

Use of collateral.

(4) A secured party may use the collateral

(a) in the manner and to the extent provided in the security agreement;

(b) for the purpose of preserving the collateral or its value; or

(c) pursuant to an order of

(i) the court before which a question relating thereto is being heard, or

(ii) a judge upon application by originating notice to all persons concerned.

Idem.

(5) A secured party

(a) is liable for any loss or damage caused by his use of the collateral otherwise than as authorized by subsection (4); and

(b) is subject to being ordered or restrained as provided in subsection (1)of section 62.

Information from the secured party.

20. (1) A debtor, execution creditor, or other person with a legal or equitable interest in, *or to the use of,* the collateral may, by a notice in writing, containing an address for reply and sent or delivered to the secured party at the address set forth in the security agreement or the financing statement, or more recent address if known, require the secured party to send or deliver to him, at the said address *or, if the request is made by the debtor, at any address required by the debtor*

(p. 119)

(a) a statement in writing of the amount of the indebtedness and of the terms of payment thereof as of the date specified in the notice;

(b) a written approval or correction as of the date specified in the notice of the itemized list of the collateral attached to the notice;

(c) a written approval or correction as of the date specified in the notice of the amount of the indebtedness and of the terms of payment thereof; and

(d) a copy of the security agreement; or any one or more of the foregoing.

Idem.

(2) If a notice is sent or delivered in accordance with the provisions of clause *(b)* of subsection (1) and if the secured party claims a security interest in all of a particular type of collateral owned by the debtor, he may so indicate in lieu of approving or correcting the itemized list of such collateral and attached to the notice.

Idem.

(3) The secured party shall *comply with* reply to a notice given under subsection (1) within fifteen days after he receives it, and, if without reasonable excuse he fails so to do or his answer is incomplete or incorrect, the person who has given the notice shall be entitled (p. 119)

(a) to recover from the secured party any direct loss or damage caused thereby; and

(b) to apply to a judge for an order requiring the secured party to comply with the notice.

Idem. (4) Where the person receiving a notice under subsection (1) no longer has an interest in the obligation or collateral, he shall, within fifteen days after he receives the notice, disclose the name and address of the latest successor in interest if known to him, and, if without reasonable excuse he fails so to do or his reply is incomplete or incorrect, he is liable for any direct loss or damage caused thereby to the person who has given the notice.

Idem. (5) A successor in interest shall be deemed to be the secured party for the purposes of this section when he receives a notice under subsection (1).

Idem. (6) A judge may

(a) exempt the secured party, in whole or in part, from complying with a notice if the person giving the notice, not being the debtor, does not establish to the satisfaction of the judge that he has a legal or equitable interest in, *or to the use of* the collateral *or that he is a creditor;* or (p . 119)

(b) extend the time for answering the notice; or

(c) make such further or other order as is reasonable and just.

(7) The secured party may require payment of the following charges:

(a) [Ten] dollars for each reply to a notice under subsection (1), but the debtor is entitled to a reply without charge once in every six months; and

(b) Fifty cents per page for each copy of the security agreement.

(8) Where the secured party has failed to comply with the requirements of subsections (1) and (2) and no exemption or extension has been ordered under subsection (6), the debtor, creditor, or other person with a legal or equitable interest in or to the use of the collateral, may apply to have the secured party∗s security interest, or any part thereof, declared void, and if in all the circumstances, and having regard to the prejudice suffered by any of the above-named parties, this is an appropriate remedy, the judge shall declare the security interest or any part thereof void. (p . 119)

(9) Where a security interest, or any part thereof, has been declared void, .t/ie person who, but for such declaration, would have been a secured party may apply to hiave the security interest reinstated and the judge may, if satisfied that it would be appropriate to do so, order the security interest to be reinstated.

(10) Where a security interest or any part thereof is ordered to be reinstated, priority in that security interest shall be determined by the latest of the following events:

(a) *The date on which the reinstatement is ordered:*
(b) *The date on which the security interest is registered:*
(c) *The date on which the secured party acquires possession of the collateral.*

PART III—PERFECTION AND PRIORITIES

Time when perfected.

21. A security interest is perfected when
(a) it has attached; and
(b) all steps required for perfection under any provision of this Act have been completed,
regardless of the order of occurrence. (p. 59)

Where unperfected security interest subordinate.

22. (1) Except as provided in subsection (2), an unperfected security interest is subordinate to
(a) the interest of a person
(i) who is entitled to a priority under this or any other Act; or

(ii) who assumes control of the collateral through legal processes, or
whose rights to collateral have, through legal process, so far crystallized that it would be inequitable to permit the secured party to defeat them; or (p. 106)

(iii) who represents the creditors of the debtor as assignee for the benefit of creditors, trustee in bankruptcy, or receiver; and

(b) the interest of a transferee who is not a secured party to the extent that he *and* gives value without knowledge of the security interest and before it is perfected (p. 105)

(i) in chattel paper, documents of title, securities, instruments or goods, under a transfer in bulk or otherwise not in the ordinary course of business of the transferor, and where the transferee receives delivery of the collateral; or (p. 92)

(ii) in intangibles *other than accounts.* (p. 92)

Purchase-money security interest.

(2) A purchase-money security interest that is registered before or within ten days after the debtor∗s possession of the collateral commences has priority over

(a) an interest set out in subclause (ii) or (iii) of clause *(a)* of subsection (1); and

(b) the interest of a transferee under a transfer in bulk or otherwise not in the ordinary course of business of the transferor, occurring between attachment and registration of the security interest.

(p. 100)

(3) A person who assumes control of collateral through legal process takes free of security interest to the extent that it secures advances made after the secured party acquires knowledge that the person has assumed control or made more than 42 days after the person assumes control, whichever first occurs, unless the advances are made pursuant to a commitment entered into before the expiration of the 42-day period and without knowledge of the assumption of control. (p. 103)

Continuity of perfection.

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

Assignee.

(2) An assignee of a security interest succeeds in so far as its perfection is concerned to the position of the assignor at the time of the assignment.

Perfection by possession.

24. Except as provided in section 26, possession of the collateral by the secured party, or on his behalf by a person other than the debtor or the debtor∗s agent, perfects a security interest in

(a) chattel paper;

(b) goods;

(c) instruments;

(d) securities;

(e) letters of credit and advices of credit; or

(f) negotiable documents of title;

but, subject to section 23, only during its actual holding as collateral. (p. 60)

Perfection by registration.

25. (l) Subject to section 21, registration perfects a security interest in

(a) chattel paper;

(b) goods;

(c) intangibles; or

(d) any type of collateral the security interest in which arises under a floating charge. (p. 60)

Idem. (2) A security interest is not perfected until it is registered, except in the case of a security interest

(a) in collateral in possession of the secured party under section 24;

(b) temporarily perfected in instruments, securities, or negotiable documents of title under section 26; *or*

(c) *perfected in accordance with subsection (3) of this section.*(p. 111)

(3) *Subject to subsection (4), a purchase-money security interest in consumer goods is perfected automatically immediately upon attachment without the need for compliance with section 24, or subsection (1) of this section, or any other provision of this Act dealing with the perfection of a security interest, except paragraph (a) of section 21.* (p. 111) *(4)* *Subsection (3) does not apply to security interests in consumer goods consisting of*

(a) *a motor-vehicle, trailer, or mobile home as defined in the* Motor Vehicle Act; *or*

(b) *fixtures; or*

(c) *a small vessel required to be licensed under section 108 of the* Canada Shipping Act; *or*

(d) *an aircraft governed by the* Aeronautics Act *(Canada).*

Temporary perfection. **26.** (1) A security interest in instruments, securities, or negotiable documents of title is a perfected security interest for the first ten days after it attaches to the extent that it arises for new value given under a written security agreement. (p. 61)

Idem. (2) *(1)* *A perfected security interest in* (p. 61)

(a) an instrument that a secured party delivers to the debt or for the purpose of

(i) ultimate sale or exchange;

(ii) presentation, collection or renewal; or

(iii) registration of transfer; or

(b) a negotiable document of title or goods held by a bailee that are not covered by a negotiabe document of title, which document of title or goods the secured party makes available to the debtor for the purpose of

(i) ultimate sale or exchange;
(ii) loading, unloading, storing, shipping, or trans-shipping; or
(iii) manufacturing, processing, packaging, or otherwise dealing with goods in a manner preliminary to their sale or exchange,

remains perfected for the first ten days, after the collateral comes under the control of the debtor.

Idem. (3) *(2)* Beyond the period of ten days referred to in subsection (1) or (2), a security interest under this section becomes subject to the provisions of this Act for perfecting a security interest.

Perfecting as to proceeds. **27.** (1) Subject to this Act, where collateral is dealt with or otherwise gives rise to proceeds the security interest therein

(a) continues as to the collateral, unless the secured party expressly or impliedly authorized such dealings; and

(b) extends to the proceeds.

Idem. (2) The security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected, but it ceases to be a perfected security interest and becomes unperfected ten days after receipt of the proceeds by the debtor unless

(a) a registered financing statement covers the original collateral and proceeds therefrom; or *and the proceeds are collateral in which a security interest may be perfected by registration in the office or offices where the financing statement has been registered and, if the proceeds are acquired with cash proceeds, the description of collateral in the financing statement indicates the types of property constituting the proceeds; or* (p. 80)

(b) *a registered financing statement covers the original collateral and proceeds therefrom and the proceeds are cash proceeds; or*

(b) *(c)* the security interest in the proceeds is otherwise perfected before the expiration of the ten-day period,

but there is no perfected security interest in proceeds that are not identifiable or traceable.

(3) *Proceeds consisting of money and cheques (including bank accounts into which they may be paid) are cash proceeds and other forms of proceeds are noncash proceeds.*

(4) *Except as provided in this section, a security interest in proceeds can be perfected only by the methods or in the circumstances permitted in this Act for original collateral of the same type.* (p. 80)

Perfecting as to goods held by bailee.

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

Idem.

(2) A security interest in goods in the possession of a bailee, other than a bailee mentioned in subsection (1), is perfected by

(a) issuance of a document of title in the name of the secured party;

(b) a holding on behalf of the secured party pursuant to section 24; or

(c) registration as to the goods; or

(d) *deposit, by a secured party to whom a non-negotiable receipt has been transferred, of the transfer with the warehouseman who issued the receipt, in accordance with section 22 (2) of the* Warehouse Receipts Act. (p. 64)

Goods returned or repossessed.

29. (1) A security interest in goods that are the subject of a sale, lease, or exchange and that are returned to, or repossessed by

(a) the person who sold, leased, or exchanged them; or

(b) a transferee of an intangible or chattel paper resulting from the sale or lease of them, reattaches to the extent that the secured indebtedness remains unpaid.

Idem.

(2) Where the security interest was perfected by a registration that is still effective at the time of the sale, lease, or exchange, it reattaches as perfected interest, but otherwise requires for its perfection a registration or a taking of possession by the secured party.

(3) A transferee of

(a) an intangible resulting from a sale or lease; or

(b) chattel paper resulting from a sale *or lease* (p. 84)

has a security interest in the goods as against the transferor.

(4) In the case of a transfer under clause *(a)* of subsection (3), such a security interest is subordinate to a security interest under subsection (1) that was a

perfected security interest when the goods became the subject of the sale, lease, or exchange, and in the case of a transfer under clause *(b),* such a security interest is prior to the security interest asserted under subsection (1) to the extent that the transferee of the chattel paper was entitled to priority under section 30.

(5) The security interest of an unpaid transferee asserted under clause *(a)* and clause *(b)* of subsection (3) must be perfected for protection against creditors of the transferor and purchasers of the returned or repossessed goods.

Effect of perfection on buyer of goods in ordinary course of business.

30. (1) A buyer or lessee of goods sold or leased in the ordinary course of business of the seller or lessor takes free from any perfected or unperfected security interest therein given by the seller or lessor whether or not the buyer or lessee knows of it, unless he also knows that the sale or lease constitutes a breach of the security agreement. (p. 269)

(2) For the purposes of subsection (1), the sale may be for cash or by exchange for other property or on credit and includes delivering goods or documents of title under a pre-existing contract for sale, but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

Idem, purchasers of chattel paper.

(3) A purchaser of chattel paper who takes possession of it in the ordinary course of his business has, to the extent that he gives new value, priority over any other security interest in it, *except a security interest claimed as the proceeds of equipment* (p. 86)

(a) that was perfected under section 25 if he did not actually know at the time he took possession that the chattel paper was subject to a security interest; or
that was perfected under section 25 if he did not know at the time that the chattel paper was subject to a security interest; or

(b) that has attached to proceeds of inventory under section 27, what ever the extent of his knowledge.
that has attached to proceeds of inventory under section 27, whatever the extent of his knowledge; or

(c) *that is perfected as to the proceeds of inventory by a registration that refers only to proceeds without expressly mentioning chattel*

paper, or types of collateral that are chattel paper, whatever the extent of his knowledge.

Idem, purchasers of non-negotiable instruments.

(4) A purchaser of a non-negotiable instrument who takes possession of it in the ordinary course of his business has priority to the extent that he gives new value over a security interest in it that was perfected under section 26 if he did not actually know at the time he took possession that the instrument was subject to a security interest.

A purchaser of an instrument who takes possession of it in the ordinary course of his business has, to the extent that he gives new value, priority over any other security interest in it, except a security interest claimed as the proceeds of equipment

(a) that was perfected under section 26 if he did not know at the time he took possession that the instrument was subject to a security interest; or (p. 93)

(b) that has attached to proceeds of inventory under section 27, whatever the extent of his knowledge; or

(c) that is perfected as to the proceeds of inventory by a registration that refers only to proceeds without expressly mentioning instruments, or types of collateral that are instruments, whatever the extent of his knowledge.

(5) A buyer, other than a buyer in the ordinary course of business, takes free of a security interest to the extent that it secures future advances made after the secured party acquires knowledge of the purchase, or more than 42 days after the purchase, whichever first occurs, unless made pursuant to a commitment entered into without knowledge of the purchase and before the expiration of the 42-day period. (p. 103)

(6) Subject to subsections (7) amid (8), a buyer of goods takes free of a perfected security interest in those goods if he buys without knowledge of the security interest, for value and primarily for his own personal, family, or household purposes, amid if the sale is not in the ordinary course of business of the seller. (p. 111)

(7) Subsection (6) does not apply to a security interest in

(a) a motor-vehicle, trailer, or mobile home as defined in the Motor-vehicle Act; *or*

(b) fixtures; or

(c) *a small vessel required to be licensed under section 108 of the* Canada Shipping Act; *or*

(d) *an aircraft governed by the* Aeronautics Act *(Canada).*

(8) *Subsection (6) does not apply if the security interest was perfected by possession of the secured party under sectiomi 24 at all material times during the negotiation, formation, and performance of the contract to buy the goods.*

Bona fide purchasers of negotiable instruments.

31. The rights of

(a) a holder in due course of a negotiable instrument;

(b) a holder of a negotiable document of title who takes it in good faith for value; or

(c) a bona fide purchaser of securities, are to be determined without regard to this Act.

Priority of liens for materials and services.

32. Where a person in the ordinary course of business furnishes materials or services with respect to the goods that are subject to a security interest, any lien that he has in respect of such materials or services has priority over a perfected security interest unless the lien is given by an Act that provides that the lien does not have such priority. (p . 266)

Alienation of rights of debtors.

33. The rights of a debtor in collateral may be transferred voluntarily or involuntarily, notwithstanding a provision in the security agreement prohibiting transfer or declaring a transfer to be a default, but no transfer prejudices the rights of the secured party under the security agreement or otherwise, including the right to treat a prohibited transfer as an act of default.

Special priorities crops.

34. (1) A perfected security interest in crops or their proceeds given for a consideration to enable the debtor to produce the crops during the production season and given not more than three months before the crops become growing crops by planting or otherwise, even though the person giving the consideration knew of the earlier security interest. (p. 54)

Idem, purchase-money security

(2) Subject to sections 30 and 31, a purchase-money security interest in the same collateral

(a) if the purchase-money security interest was perfected at the time the

interests debtor received possession of the collateral *inventory*; and (p. 97)

inventory. *(b)* if any secured party, whose security interest was actually known to the holder of the purchase-money security interest or who, prior to the registration by the holder of the purchase-money security

interest before the debtor received possession of the collateral covered by the purchase-money security interest; and

if the purchase-money secured party gives notification in writing to the holder of the conflicting security interest, if the holder had registered a financing statement covering the same items or types of inventory

(i) *before the date of registration by the purchase-money secured party; or*

(ii) *before the beginning of the ten-day period when the purchase-money security interest is temporarily perfected without registration or possession under section 26 (1); and*

(c) if such notification stated that the person giving the notice had *acquired*, or expected to acquire, a purchase-money security interest in the inventory of the debtor, describing such inventory by item or type. (p. 97)

Provided, however, that a security interest in proceeds shall not have priority over a security interest in accounts given for new value where a financing statement relating thereto has been registered before the purchase-money security interest in inventory was perfected or a financing statement relating thereto was registered. (p. 97)

Idem, purchase-money security interests (3) A purchase-money security interest in collateral or its proceeds, other than inventory, has priority over any other security interest in the same collateral if the purchase-money security interest was perfected at the time the debtor

other than inventory. obtained possession of the collateral or within ten days thereafter. (p. 99)

Priorities general rule. **35.** (1) If no other provision of this Act is applicable, priority between security interests in the same collateral shall be determined

(a) by the order of registration, if the security interests have been perfected by registration;
by the order of registration or perfection, whichever is earlier; and (p. 78)

(b) by the order of perfection, unless the security interests have been perfected by registration; or
as between unperfected security interests, by the order of attachment;

(c) by the order of attachment under subsection (1) of section 12, if no security interest has been perfected.

Idem. (2) For the purposes of subsection (1), a continuously perfected security interest shall be treated at all times as if perfected by registration, if it was

originally so perfected, and it shall be treated at all times as if perfected otherwise than by registration if it was originally perfected otherwise than by registration.

For the purposes of subsection (1) a date of registration or perfection as to collateral is also a date of registration or perfection as to its proceeds. (p. 78)

Fixtures. **36.** (1) *(a)* This section does not apply to building materials; (p. 54)

(b) "building materials" includes goods that are or become so incorporated or built into a building that their removal therefrom would necessarily involve the removal or destruction of some other part of the building and thereby cause substantial damage to the building apart from the value of the goods removed, but does not in-

clude goods that are severable from the building or land merely by unscrewing, unbelting, unclamping, or uncoupling, or by some other method of disconnection, and does not include machinery installed in a building for use in the carrying-on of an activity where the only substantial damage, apart from the value of the machinery removed, that would necessarily be caused to the building in removing the machinery therefrom is that arising from the removal or destruction of the bed or casing on or in which the machinery is set and the making or enlargement of an opening in the walls of the building sufficient for the removal of the machinery;

(c) "building:" includes a structure, erection, mine, or work btiilt, erected, or constructed on or in land.

Priority of security interests, fixtures.

(2) Subject to subsection (4) of this section and notwithstanding subsection (3) of section 34, a security interest that attached to goods before they become fixtures has priority as to the goods over the claim of any person who has an interest in the real property.

Idem.

(3) Subject to subsection (4), a security interest that attached to goods after they became fixtures has priority over the claim of any person who subsequently acquired an interest in the real property, but not over any person who had a registered interest in the real property at the time the security interest attached to the goods and who has not consented in writing to the security interest or disclaimed an interest in the goods as fixtures.

Exceptions.

(4) The security jnterests referred to in subsections (2) and (3) are subordinate to the interest of

(a) a subsequent purchaser for value of an interest in the real property;

(b) a creditor with a subsequent lien on the real property obtained through legal process; or

(c) a creditor with a prior encumbrance of record on the real property in respect of subsequent advances,

if the subsequent purchase is made or the lien is obtained or the subsequent advance under the prior encumbrance is made or contracted for, as the case may be, without knowledge of the security interest and before it is perfected in accordance with the provisions of *section 46 (2).*

Removal of collateral.

(5) If a secured party, by virtue of subsection (2) or (3) and subsection (4) has priority over the claim of a person having an interest in the real property, he may on default, subject to the provisions of this Act respecting default, remove his collateral from the real property if, unless otherwise agreed, he reimburses any encumbrancer or owner of the real property who is not the debtor for the cost of repairing any physical injury, excluding diminution

in the value of the real property caused by the absence of the goods removed or by the necessity for replacement, but a person so entitled to reimbursement may refuse permission to remove until the secured party has given adequate security for any reimbursement arising under this subsection.

Retention of collateral.

(6) A person having an interest in real property is subordinate to a security interest by virtue of subsection (2) or (3) and subsection (4) may, before the collateral has been removed from the real property by the secured party in accordance with subsection (4), retain the collateral upon payment to the secured party of the amount owing under the security interest having priority over his claim.

Accessions.

37. (1) Subject to subsection (2) and to section 38 and notwithstanding subsection (3) of section 34, (p. 55)

(a) a security interest in an accession that attached before the goods became an accession has priority as to the accession over the claim of any person in respect of the whole; and

(b) a security interest in goods that attached after the goods became an accession has priority over the claim of any person who subsequently acquired an interest in the whole, but not against a person who had an interest in the whole at the date of attachment of the security interest in the accession and who has not consented in writing to the security interest in the accession or disclaimed an interest in the accession as part of the whole.

Exceptions.

(2) A security interest referred to in subsection (1) is subordinate to the interest of

(a) a subsequent purchaser for value of an interest in the whole; or

(b) a creditor with a lien on the whole, subsequently obtained as a result of judicial process; or

(c) a creditor with a prior perfected security interest in the whole to the extent that he makes subsequent advances,

if the subsequent purchase was made, the lien was obtained, or the subsequent advance under the prior perfected security interest was made or contracted for without knowledge of the security interest and before it is perfected.

Removal of collateral.

(3) If a secured party, by virtue of subsections (1) and (2), has an interest in an accession that has priority over the claim of any person having an interest in the whole, he may, on default, subject to the provisions of this Act respecting default, remove his collateral from the whole if, unless otherwise

agreed, he reimburses any encumbrancer or owner of the whole who is not the debtor for the cost of repairing any physical injury excluding diminution in value of the whole caused by the absence of the goods removed or by the necessity for replacement, but a person so entitled to reimbursement may refuse permission to remove until the secured party has given adequate security for any reimbursement arising under this subsection.

Retention of collateral.

(4) A person having a security interest in the whole that is subordinate to a security interest by virtue of subsections (1) and (2) may, before the collateral has been removed by the secured party in accordance with subsection (3), retain the collateral upon payment to the secured party of the amount owing under the security interest having priority over his claim. (p. 56)

Commingled goods.

38. A perfected security interest in goods that subsequently become part of a product or mass continues in the product or mass if the goods are so manufactured, processed, assembled, or commingled that their identity is lost in the product or mass, and, if more than one security interest attaches to the product or mass, the security interests rank equally according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total product or mass. (p. 56)

Priority subject to subordination.

39. A secured party my in the security agreement or otherwise, subordinate his security interest to any other security interest. (p. 56)

Account debtors.

40. (1) Unless a debtor on an intangible or chattel paper has made an enforceable agreement not to assert defences or claims arising out of a contract, the rights of an assignee are subject to (p. 88)

(a) all the terms of the contract between the debtor on an intangible or chattel paper and the assignor and any defence or claim arising therefrom; and

(b) any other defence or claim of the debtor on an intangible or chattel paper against the assignor that accrued before the debtor on an intangible or chattel paper received notice of the assignment.

(2) So far as the right to payment under an assigned contract right has not been earned by performance, and notwithstanding notification of the assignment, any modification of or substitution for the contract made in good faith and in accordance with reasonable commercial standards and without material adverse effect upon the assignee∗s right under or the as-

signor∗s ability to perform the contract is effective against as assignee unless the debtor on an intangible or chattel paper has otherwise agreed, but the assignee acquires corresponding rights under the modified or substituted contract. The assignment may provide that such modification or substitution is a breach by the assignor. (p. 87)

Idem. (3) The debtor on an intangible or chattel paper may pay the assignor until the debtor on an intangible or chattel paper receives notice, reasonably identifying the relevant rights, that the account has been assigned, and if requested by the debtor on an intangible or chattel paper, the assignee shall furnish proof within a reasonable time that the assignment has been made, and, if he does not do so, the debtor on an intangible or chattel paper may pay the assignor.

(4) A term in any contract between a debtor on an intangible or chattel paper and an assignor which prohibits assignment of the whole of an account is ineffective.

PART IV-REGISTRATION

Registration system. **41.** (1) A registration system, including a central office and branch offices, shall be established for the purposes of this Act.

Central Office. (2) The central office of the registration system shall be located at .....**.**

Branch office. (3) Branch offices of the registration system shall be established at such places as are designated by the regulations.

Office of the Provincial Secretary. (4) The Office of the Provincial Secretary (or Registrar of Companies, as the cases may be) shall be the registration office for corporate securities. (p. 148)

Registrar appointment. **42.** (1) There shall be a registrar of personal property security and a branch registrar for each branch office.

Function. (2) It shall be the function of the registrar, under the direction of the Inspector of Legal Offices, to supervise the operation of the registration system established for the purposes of this Act.

Seal of (3) The registrar and each branch registrar shall have a seal of office in such

office. form as the Lieutenant-Governor in Council approves.

Signing officers. **43.** The registrar and each branch registrar may designate one or more persons on the staff of his office to act on his behalf.

Registrar's certificate. **44.** (1) Upon the request of any person and upon payment of the prescribed fee,

(a) the registrar shall issue a certificate stating whether there is registered at the time mentioned in the certificate a financing statement or other document in which the person named in the certificate is shown as a debtor and, if there is, the registration number of it, and nay other information recorded in the central office of the registration system or the office of the Provincial Secretary (or Registrar of Companies); (p. 148)

(b) any registered financing statement or other document shall be provided for inspection at the branch office where it was registered; and

(c) a certified copy of any security agreement, *financing statement*, or other document shall be furnished at the branch office where it was registered.

Proof of certification. (2) A certificate issued under clause *(a)* of subsection (1) is prima facie evidence of the contents thereof.

Proof of certified copies. (3) A certified copy furnished under clause *(c)* of subsection (1) is prima facie evidence of the contents of the document so certified.

(4) Every certificate issued under clause (a) of subsection (1) may contain a warning in such words as may be prescribed by regulation concerning its accuracy. (pp. 139,148)

Assurance **45.** (1) There shall be an account in the Consolidated Revenue Fund to be

fund.

known as "The Personal Property Security Fund," referred to in this section as "the Fund," into which shall be paid the prescribed portion of the fees received under this Act.

Interest. (2) Interest shall be credited to the Fund our of the Consolidated Revenue Fund at a rate to be determined from time to time by the Lieutenant-Governor in Council, and such interest shall be made up at the close of each fiscal year upon the balance in the Fund at the end of the previous calendar year.

Persons suffering damage to be compensated.

(3) Any person who suffers loss or damage as a result of his reliance upon a certificate of the registrar issued under section 44 that is incorrect because of an error or omission in the operation of the system of registration, recording, and production of information under this Part, is entitled to have compensation paid to him out of the Fund so far as the Fund is sufficient for that purpose, having regard to any other charges thereon, if he makes a claim therefor under subsection (4) within one year for the time of his having suffered the loss or damage.

Claim for compensation.

(4) A person claiming to be entitled to payment of compensation out of the Fund shall make an application therefor in writing to the registrar, setting our therein his full name and address and the particulars of his claim.

Reference to certificate.

(5) The registrar shall refer the application to the ....., who shall issue such directions as he thinks proper, hold a hearing, determine the claimant's entitlement to compensation, the amount thereof, and, if awarded, the costs of the proceedings.

(6) The ..... shall make his findings and embody his conclusions in the form of a certificate and send by registered mail one copy thereof to the claimant at the address shown in the application and one copy to the registrar.

Confirmation of certificate.

(7) The certificate of the ..... shall be deemed to be confirmed at the expiration of 30 days from the date of mailing it to the claimant, unless notice of appeal is served within that time.

Appeal.

(8) The claimant or the registrar may appeal to the ..... at any time before the certificate of the ..... is confirmed, and the procedure thereon shall be the same as upon an appeal from a report when a whole action has been referred under .....**.**

Payment out of fund.

(9) When the registrar receives a certificate of the ..... under subsection (6) and the time for any appeal has expired or, where an appeal is taken, it is disposed of, and it is finally determined that the claimant is entitled to

payment of compensation out of the Fund, the registrar shall certify to the ..... the sum found to be payable, including any costs awarded to the claimant, and the ..... shall pay such sum to the claimant out of the Fund.

Where documents to be registered,

46. (1) Subject to subsection (2), documents to be registered under this Act shall be tendered for registration at any branch office established under subsection (3) of section 41.

effective time of registration.

(2) Corporate securities and documents relating thereto shall be tendered for registration at the ..... office.

(3) In order to perfect, as against interests in real property, a security interest in crops which are growing or to be grown or in goods before or after hey have become fixtures, the registration provisions of [insert name of the relevant *Land Titles* or *Land Registry*] *Act* must be complied with.

(2) In order to perfect, as against interests in real property to which the Land Registry Act *applies a security interest in crops which are growing or to be grown or in goods before or after they have become fixtures, a copy of the financing statement and such form of application for filing as may be prescribed shall also be filed in the relevant Land Registry Office.*

(4) *(3)* A security interest in crops or in fixtures may be perfected as a security interest in goods without also being perfected pursuant to subsection (2).

(5) *(4)* Any registration under this Act is effective only from the time of recording of the prescribed particulars thereof in the central office and the assignment thereto of a registration number.

ALTERNATIVE A

47. (1) In order to register under this Act for the purpose of perfecting a security interest a financing statement signed by the debtor shall be registered which contains and legibly sets forth

(a) the name and address of the debtor;

(b) the name and address of the secured party;

(c) a description of the collateral sufficient to enable it to be identified; and

a statement indicating the types, or describing the items, of collateral; and

(d) such other information, including information referred to in clauses *(a)* to *(c)* of this subsection and the mode of giving the information, as may be prescribed by regulations made under this Act.

A financing statement may be registered at any time and before a security agreement is made or a security interest attaches.

(2) A financing statement which is not signed by the debtor, but otherwise complies with subsection (I), may be registered if

(a) it is accompanied by a copy of the security agreement signed by the debtor; or

(b) it is signed by the secured party and is registered to perfect a security interest in

(i) collateral already subject to a security interest in another jurisdiction or subject to a right to revendicate or to resume possession pursuant to Article 1998 of the *Civil Code* of the Province of Quebec when the collateral is brought into [insert name of province], if the financing statement contains a statement that the collateral was brought into [insert name of province] under such circumstances;

(ii) proceeds under section 27, if the security interest in the original collateral that gave rise to such proceeds was perfected and the financing statement describes the original collateral and contains the registration number of the related financing statement if the security interest in the original collateral was perfected by registration.

ALTERNATIVE B

47. (1) In order to register under this Act for the purpose of perfecting a security interest, the security agreement or a copy thereof signed

by the debtor shall, ..., be registered, and it shall contain and legibly set forth at least,

(a) the name and address of the debtor;

(b) the name and address of the secured party;

(c) the date of execution of the security agreement;

(d) a description of the collateral sufficient to identify it; and

(e) the terms and conditions of the security agreement.

(2) Where the collateral is inventory or accounts, a financing statement signed by the debtor, which contains and legibly sets forth at least

(a) the name and address of the debtor;

(b) the name and address of the secured party; and

(c) a description of the collateral sufficient to enable it to be identified; and

(d) such other information, including information referred to in clauses *(a)* to *(c)* of this subsection and the mode of giving the information, as may be prescribed by the regulations made under this Act,

may, in lieu of the security agreement under subsection (1), be registered in order to perfect a security interest in such collateral.

(3) A financing statement which is not signed by the debtor, but otherwise complies with clauses *(a)* to *(d)* of subsection (2), may be registered if

(1) it is accompanied by a copy of the security agreement signed by the debtor; or

(ii) it is signed by the secured party and is registered to perfect a security interest in

(a) collateral already subject to a security interest in another jurisdiction or subject to a right to

revendicate or to resume possession pursuant to Article 1998 of the *Civil Code* of the Province of Quebec when the collateral is brought into [insert name of province], if the financing statement contains a statement that the collateral was brought into [insert name of province] under such circumstances;

(b) proceeds under section 27, if the security interest in the original collateral that gave rise to such pro-

ceeds was perfected and the financing statement describes the original collateral and contains the registration number of the related financing statement if the security interest in the original collateral was perfected by registration.

Assignments. **48.** (1) A financing statement may disclose an assignment of a security interest in the collateral described in the statement if the statement contains and legibly sets forth the name and address of the assignee and is signed either by the original secured party or the assignee.

Idem. (2) A statement of assignment, signed by the secured party of record, of a security interest evidenced by a registered financing statement may be registered if it contains and legibly sets forth at least

(a) the name and address of the debtor;

(b) the name and address of the secured party of record;

(c) the name and address of the assignee; and

(d) the registration number of the financing statement.

(3) After disclosure of an assignment or registration of a statement of assignment under this section, the assignee becomes the secured party of the record.

Assignment of collateral by debtor. **49.** (1) Where a security interest has been perfected by registration and the debtor with the consent of the secured party assigns his interest in the collateral, the assignee becomes a debtor and the security interest becomes and remains unperfected until the secured party registers a notice in the prescribed form.

When security interest becomes unperfected. (2) Where a security interest has been perfected by registration and the secured party learns that the debtor has assigned his interest in the collateral, the security interest becomes unperfected *fifteen days* after the secured party

perfected. learns of the assignment and the name and address of the assignee, unless he registers a notice in the prescribed form within such fifteen days.

Second registration.

(3) A security interest that becomes perfected under subsection (1) or (2) may thereafter be perfected by registering a notice in the prescribed form or as otherwise provided by this Act.

49. *(1) Where a security interest has been perfected by registration and the debtor assigns his interest in the collateral the assignee becomes a debtor and*

(p. 90)

(a) notwithstanding paragraphs (b) and (c), the security interest becomes and remains unperfected against purchasers for value of the collateral who do not know that the collateral was subject to a security interest, and against persons deriving title from such purchasers, if at the time of the purchase the secured party has not registered a notice in the prescribed form;

(b) where the assignment was with the consent of the secured party, the security interest becomes and remains unperfected until the secured party registers a notice in the prescribed form;

(c) where the secured party learns that the debtor has assigned his interest in the collateral, the security interest becomes unperfected 15 days after the secured party learns of the assignment and the name and address of the assignee, unless he registers a notice in the prescribed form within such 15 days.

(2) A security interest that becomes unperfected under paragraphs (b) or (c) of subsection (1) may thereafter be perfected by registering a notice in the prescribed form or as otherwise provided by this Act.

Amendments. **50.** (1) An amendment to a financing statement or other document

registered under this Act may be registered at any time during the period that the registration of the amended document is effective.

(2) If the amendment adds collateral, it is effectively registered as to the additional collateral only from the date of registration of the amendment.

(3) An amendment must be signed by the debtor and must refer to the registration number of the document which it amends.

(4) Upon notice to the debtor a judge may make an order dispensing with the debtor∗s signature to the filing of a document under subsection (3).

Sub-ordination.

51. A separate agreement signed by the secured party of record that provides for the subordination of a security interest created or provided for by a security agreement in respect of which a financing statement has been registered under this Act and that refers to the registration number of the financing statement may be registered at any time during the period that the registration of the financing statement or any renewal thereof is effective.

Renewal statements.

52. A renewal statement in the prescribed form that is signed by the secured party of record may be registered at any time.

Effect of registration.

53. (1) Registration under this Act

(a) of a financing statement or renewal statement is effective for a period of three years following the registration of the financing statement or renewal statement, as the case may be;

(b) of any other document is effective for the remainder of the period for which the financing statement to which the document relates or any renewal thereof is effective.

(2) The time limits in clauses *(a)* and *(b)* of subsection (1) shall not apply to corporate securities.

Discharge of security agreement.

54. (1) Upon performance of all obligations under a security agreement, it shall be discharged, and, upon written demand delivered either personally or by registered mail during the period that the registration of the financing statement is effective by any person having an interest in the collateral to the secured party, the secured party shall sign and deliver personally or by registered mail to the person demanding it, at the place set out in the demand, a certificate of discharge in the prescribed form together with unregistered assignments, if any, of the security agreement.

(2) Where the secured parly has agreed to release part of the collateral upon payment or performance of certain of the obligations under a security agreement, then, upon payment or performance of such obligations and upon written demand delivered either personally or by registered mail during the period that the registration of the financing statement is effective

by any person having an interest in the collateral to the sectired party, the secured party shall sign and deliver personally or by registered mail to the person demanding it, at the place set out in the demand, a release in the prescribed form of the collateral as agreed.

Failure to deliver.

(3) Where the secured party, without reasonable excuse, fails to deliver the required discharge and assignments or release, as the case may be, within ten days after receipt of a demand therefor under subsection (I) or (2), he shall pay $100 to the person making the demand and any damages resulting from the failure, which sum and damages are recoverable in any court of competent jurisdiction.

Security or payment into court.

(4) Upon the application to the ..... court by originating notice to all persons concerned, the judge may

(a) allow security for or payment into court of the amount claimed by the secured party and such costs as he may fix, and thereupon order that the registration of the financing statement be discharged or that a release of collateral be registered, as the case may be; or

(b) order upon any ground he deems proper that the registration of the financing statement be discharged or that a release of collateral be registered, as the case may be.

Registration of discharges and releases.

(5) Any discharge of a financing statement and any release of collateral may be registered under this Act.

Original or copy of documents.

54A. A document that is required or permitted to be registered under this Act may be either the original document or a true copy thereof. "True copy" includes a legible copy of the original document produced by photographic,
electrical, or mechanical means. Where a true copy of the document is registered, any signature thereon may be a reproduction of the signature on the original document or a copy thereof in type or writing, indicated by means of inverted commas. For the purposes of this Act a writing shall be deemed to be signed by a person when it is signed by such person or his authorized agent.

54AA. Registration of a document shall not constitute constructive notice of its contents to third parties unless otherwise provided in this Act.

54AA. *Registration of a document shall not constitute constructive notice or knowledge of its contents, the security interest to which it refers, nor of the document itself to third parties unless otherwise provided in this Act.* (p. 115)

PART V - DEFAULT - RIGHTS AND REMEDIES

Rights and remedies cumulative and exclusions.

55. (1) The rights and remedies referred to in this Part are cumulative.

Unless otherwise provided, Part V does not apply to assignment of accounts or chattel paper not intended as security.

55. *(1) The rights and remedies referred to in this Part are cumulative. Unless otherwise provided, Part V does not apply to*

(a) assignments of accounts or chattel paper not intended as security; or

(b) leases of goods or consignments not intended as security; or

(c) a sale of goods which is not in the ordinary course of business of the seller if the seller remains in possession of the goods after the buyer has a right to possession thereof. (p. 306)

Secured party's rights.

(2) Where the debtor is in default under a security agreement, the secured party has, in addition to any other rights and remedies, the rights and remedies provided in the security agreement except as limited by subsection (5), the rights and remedies provided in this Part and, when in possession, the rights, remedies and duties provided in section 19.

Appointment of receiver.

(2a) Nothing in this Act shall preclude the parties to a security agreement from agreeing that the secured party may appoint a receiver or to prevent a court from appointing a receiver and determining his rights and duties.

Secured remedies.

(3) The secured party may enforce the security interest by any method party∗s available in or permitted by law, and if the collateral is or includes documents of title, the secured party may proceed either as to the documents of

title or as to the goods covered thereby, and any method of enforcement that is available with respect to the documents of title is also available, *mutatis mutandis,* with respect to the goods covered thereby.

Debtor's rights and remedies.

(4) Where the debtor is in default under a security agreement, he has, and in addition to the rights and remedies provided in the security agreement and any other rights and remedies, the rights and remedies provided in this Part and in section 19.

Waiver and variation of rights and duties.

(5) Except as provided in sections 60 and 61, the provisions of subsections (3), (4), and (5) of section 58 and of sections 59, 60, 61, and 62, to the extent that they give rights to the debtor and impose duties upon the secured party, shall not be waived or varied, but the parties may by agreement determine the standards by which the rights of the debtor and the duties of the secured party are to be measured, so long as such standards are not manifestly unreasonable having regard to the nature of such rights and duties.

Where agreement covers both real and personal property.

(6) Where a security agreement covers both real and personal property, the secured party may proceed under this Part as to the personal property or he may proceed as to both the real and the personal property in accordance with his rights and remedies in respect of the real property, in which case this Part does not apply.

No merger in judgment.

(7) A security interest does not merge merely because a secured party has reduced his claim to judgment.

Collection rights of a secured party.

56. (1) Where so agreed and in any event upon default under a security agreement, a secured party is entitled

(a) to notify any debtor on an intangible or chattel paper or any obligor on an instrument to make payment to him whether or not the assignor was theretofore making collections on the collateral; and

(b) to take control of any proceeds to which he is entitled under section 27.

Idem.

(2) A secured party who by agreement is entitled to charge back uncollected collateral or otherwise to full or limited recourse against the debtor and who undertakes to collect from the debtors on intangibles or chattel paper or obligors on instruments shall proceed in a commercially reasonable

manner and may deduct his reasonable expenses of realization from the collections.

Secured party's right to take possession.

57. Upon default under a security agreement,

(a) the secured party has, unless otherwise agreed, the right to take possession of the collateral by any method permitted by law;

(b) if the collateral is equipment and the security interest has been perfected by registration, the secured party may, in a reasonable manner, render such equipment unusable without removal thereof from the debtor∗s premises, and the secured party shall thereupon be deemed to have taken possession of such equipment; and

(c) the secured party may dispose of collateral under section 53 on the debtor∗s premises; but

(d) if the collateral are goods that have become a fixture, the secured party shall not be entitled to remove the goods from the premises to which they are affixed unless he has given to each person who appears by the records of the *Land Registry Office* to have an interest in the premises a notice in writing of his intention to remove the goods and unless each person so notified fails to pay the amount due and payable on the goods for a period of 20 days after the giving of the notice to him or for such longer period as a judge of the..... court may fix on cause shown to his satisfaction.

Secured party's right to dispose of collateral upon default.

58. (1) Upon default under a security agreement, the secured party may dispose of any of the collateral in its condition either before or after any commercially reasonable repair, processing, or preparation for disposition, and the proceeds of the disposition shall be applied consecutively to

(a) the reasonable expenses of retaking, holding, repairing, processing, preparing for disposition, and disposing of the collateral and, to the extent provided for in the security agreement and not prohibited by law, any other reasonable expenses incurred by the secured party;

(b) the satisfaction of the obligation secured by the security interest of the party making disposition; and

(c) the satisfaction of the obligation secured by any subordinate security interest in the collateral if written demand therefor is received by the party making the disposition before the distribution of the proceeds is completed.

Request for proof of

(2) Where a written demand under clause (c) of subsection (1) is received by the secured party, he may request the holder of the subordinate security

interest.

interest to furnish him with reasonable proof of such holder's interest, and, unless such holder furnishes such proof within a reasonable time, the secured party need not comply with such demand.

Methods of disposition.

(3) Collateral may be disposed of in whole or in part, and any such disposition may be by public sale, private sale, lease, or otherwise and, subject to subsection (5), may be made at any time and place and on any terms so long as every aspect of the disposition is commercially reasonable.

Secured party's right to delay disposition of collateral.

(4) The secured party may, subject to subsection (1) of section 60, retain the collateral in whole or in part for such period of time as is commercially reasonable.

Secured party to give notice of disposition of collateral.

(5) Unless the collateral is perishable or unless the secured party believes on reasonable grounds that the collateral will decline speedily in value, the secured party shall give to the debtor and to any other person who has a security interest in the collateral an who has registered a financing statement under this Act indexed in the name of the debtor or who is known by the secured party to have a security interest in the collateral not less than fifteen day's notice in writing of his intention to dispose of the collateral. The notice shall contain

(a) a brief description of the collateral;

(b) the amount required to satisfy the obligation secured by his security interest;

(c) the sums actually in arrear, exclusive of the operation of any acceleration clause in the security agreement, or a brief description of any other provisions of the security agreement for the breach of which the secured party intends to dispose of the collateral;

(d) the amount of the applicable expenses referred to in clause *(a)* of subsection (1) or, in a case where the amount of such expenses has not been determined, his reasonable estimate thereof;

(e) a statement that upon payment of the amounts due under clauses *(b)* and *(d)* of subsection (5) the debtor may redeem the collateral;

(f) a statement that upon payment of the sums actually in arrear or the curing of any other default, as the case may be, together with the amounts due under clause *(a)* of subsection (1), the debtor may reinstate the security agreement;

(g) a statement that unless the collateral is redeemed or the security agreement is reinstated the collateral will be disposed of and the debtor may be liable for any deficiency; and

(h) the date, time, and place of any public sale or of the date after which any private disposition of the collateral is to be made.

Service of notice.

(6) The notice required by subsection (5) shall be served personally upon or left at the residence or last known place of abode of the party to be served or may be sent by registered mail to his last known post office address.

Secured party's right to purchase collateral.

(7) The secured party may purchase the collateral or any part thereof only at a public sale.

Effect of disposition on collateral.

(8) Where collateral is disposed of in accordance with this section, the disposition discharges the security interest of the secured party making the disposition and, if such disposition is made to a bona fide purchaser for value, discharges also any subordinate security interest and terminates the debtor's interest in the collateral.

Idem.

(9) Where collateral is disposed of by a secured party after default otherwise than in accordance with this section, then

(a) in the case of a public sale, if the purchaser has no knowledge of any defect in the sale and if he does not purchase in collusion with the secured party, other bidders or the person conducting the sale; or

(b) in any other case, if the purchaser acts in good faith,

the disposition discharges the security interest of the secured party making the disposition and, where the disposition is made to a purchaser for value, discharges also any subordinate security interest and terminates the debtor∗s interest in the collateral.

Certain transfers of collateral.

(10) A person who is liable to a secured party under a guarantee, endorsement, covenant, repurchase agreement, or the like and who receives a transfer of collateral from the secured party or is subrogated to his rights has thereafter the rights and duties of the secured party, and such a transfer of collateral is not a disposition of the collateral.

(11) Subsections (5) and (6) shall not apply to a corporate security or if a receiver or manager has been appointed by a court or pursuant to the provisions of the security agreement.

Surplus or

59. Where a security agreement secures an indebtedness and the secured party

deficiency. has dealt with the collateral under section 56 or has disposed of it in accordance with section 58 or otherwise, he shall account for any surplus to any person, other than the debtor, whom the secured party knows to be the owner of the collateral, and, in the absence of such knowledge, he shall account to the debtor for any surplus, and unless agreed the debtor is liable for any deficiency.

Compulsory disposition of collateral

60. (1) Where the security agreement secures an indebtedness and the collateral is consumer goods and the debtor has paid at least 60 per cent of the indebtedness secured and has not signed, after default, a

consumer goods. statement renouncing or modifying his rights under this Part, the secured party who has taken possession, dispose of or contract to dispose of the collateral under section 58, and, if he fails to do so, the debtor may proceed under section 62 or in an action for damages or loss sustained. (p. 144)

Retention of collateral.

60. *(1)* In any case other than mentioned in subsection (1), a secured party in possession of the collateral may, after default, propose to retain the collateral in satisfaction of the obligation secured, and notification of such proposal shall be given to the debtor and to any other person whom such secured party knows to be the owner of the collateral and, except in the case of consumer goods, to any other person who has a security interest in the collateral and who has registered a security agreement under this Act indexed in the name of the debtor or who is known by the secured party in possession to have a security interest in the collateral.

Idem. *(2)* If any person entitled to notification under subsection *(1)* objects in writing within fifteen days after being notified, the secured party in possession shall dispose of the collateral under section 58, and, in the absence of any such objection, such secured party shall, at the expiration of such period of fifteen days, be deemed to have irrevocably elected to retain the collateral in satisfaction of the obligation secured, and thereafter is entitled to hold or dispose of the collateral free of all rights and interests therein of any person entitled to notification under subsection *(1)* who was given such notification.

Redemption

61. (1) At any time before the secured party has disposed of the collateral

of collateral.

by sale or exchange or contracted for such disposition under section

58 or before the secured party shall be deemed to have irrevocably elected to retain the collateral in satisfaction of the obligation under subsection *(1)* of section 60, the debtor, or any person other than the debtor who is the owner of the collateral, or any secured party other than the secured party in possession, may, unless he has otherwise agreed in writing after default, either

(a) redeem the collateral by tendering fulfilment of all obligations secured by the collateral; or

(b) reinstate the security agreement by paying the sums actually in arrear, exclusive of the operation of any acceleration clause, or by curing any other default by reason whereof the secured party intends to dispose of the collateral,

together with a sum equal to the reasonable expenses of retaking, holding, repairing, processing, preparing the collateral for disposition and in arranging for its disposition, and, to the extent provided for in the security agreement, the reasonable solicitor∗s costs and legal expenses.

(2) Clause *(b)* of subsection (1) shall not apply to a corporate security.

Remedies for failure of secured party to comply with this Part.

62. (1) Where a secured party in possession of collateral is not complying with an obligation imposed by section 19 or, after default, is not proceeding in accordance with this Part or the account is disputed, the debtor or any person who is the owner of the collateral or the creditors of either of them or any person who is the owner of the collateral may apply to the ..... court having jurisdiction with respect thereto, and the court may, upon hearing any such application, direct that the secured party comply with the obligations imposed by section 19, or that the collateral be or be not disposed of, or order an account to be taken or make such other or further order as the court deems just.

Idem.

(2) If the disposition of the collateral has been made otherwise than in accordance with this Part

(a) the debtor or any other person entitled to notice under subsection

(5) of section 58 or whose security interest has been known to the secured party prior to the disposition has a right to recover from the secured party any loss or damage caused by his failure to comply with this Part; and

(b) where the collateral is consumer goods, the debtor has a right to recover in any event an amount not less than the credit service charge plus ten per cent of the principle amount of the debt or the time price differential plus ten per cent of the cash price. (p. 144)

Removal of proceedings into Supreme Court.

(3) Where an application under subsection (1) is made to a ..... court, a respondent may, by notice served on the applicant and on the other respondents, if any, and filed with proof of service thereof with the clerk of the ..... court not later than the two days preceding the day of the return of the application, require the proceedings to be removed into the ..... court.

Transmission of proceedings.

(4) Upon the filing of the notice and proof of service thereof, the clerk of the ..... court shall forthwith transmit the papers and proceedings to the proper office of the ..... court in the county or district in which the application is made.

Removal of proceedings.

(5) When the papers and proceedings are received at the proper office of the ..... court, the proceedings are *ipso facto* removed into the ..... court.

Reference to master.

(6) Where an application under subsection (1) is made to or is removed into the ..... court, the court may refer any question to a master or other officer for inquiry and report.

Appeal.

(7) An appeal lies to the ..... court form any order made under this section.

PART VI—MISCELLANEOUS

Extention of time.

63. (1) Where in this Act any time is prescribed within which or before which any act or thing must be done, a judge on application may, upon such terms and conditions and with such notice, if any, as he may order, extend such time for compliance upon being satisfied that no interest of any other person will be prejudiced by such extention, but, in the event that it later appears that any such act or

thing done within the period so extended has prejudiced the rights that any person acquired before the doing of such act or thing, such act or thing shall be presumed not to have been done in conformity with this Act for the purpose of ascertaining the right that such person acquired before the doing of such act or thing.

Idem. (2) A copy of an order made under subsection (1) shall for purposes of registration be attached to the document to which the order relates.

64. (1) Transactions validly entered into before this section comes into force and the rights, duties, and interests flowing from them remain valid and binding thereafter and may be terminated, completed, consummated, or enforced as required or permitted by any statute or other law repealed or modified by this Act as though such repeal or modification had not occurred.

(2) The order of priorities between a security interest validly created under any prior law and a security interest validly created under this Act shall be determined by the prior law.

64. *This Act applies to every prior security interest, as defined in section 65 (1) (a), which has not been validly terminated, completed, consummated, or enforced in accordance with the prior law before this section came into force.* (p . 133)

65. Every security interest that was covered by an unexpired filing or registration under the *Assignment of Book Debts Act*, the *Bills of Sale and Chattel Mortgages Act*, and the Conditional Sales Act when this section came into force shall be deemed to have been registered and perfected under this Act and, subject to this Act, such registration continues the effect of the prior filing or registration for the unexpired portion of the filing or registration period.

65. *(1) In this section*

(a) "prior security interest" means a transaction, lease, assignment, sale, or consignment validly created or entered into before this section came into force, which is a security interest within the mean-

ing of this Act and to which this Act would have applied if it had been in force at the time the transaction, lease, assignment, sale, or consignment was created or entered into (p. 130)

(b) *"prior registration law" means the* Assignment of Book Accounts Act*, the* Bill of Sale Act, *and any Act which incorporates, by reference, sections 73 to 82 of the* Companies Act *as part of that Act.*

(2) *A prior security interest that, when this section came into force, was covered by an unexpired filing or registration under a prior registration law shall be deemed to have been registered under this Act and, subject to this Act, such registration continues the effect of the prior filing or registration for the unexpired portion of the filing or registration period, and the effect of the prior filing or registration may be further continued by the registration of a renewal statement under this Act.*

(3) *A prior security interest validly created, reserved, or provided for under any prior law which gave that interest the priority of a perfected security interest without filing or registration under any prior registration law or without the secured party's taking possession of the collateral is perfected within the meaning of this Act as of the date the security interest attached, and that perfection continues for three years from the date this section came into force without registration under this Act, after which it becomes unperfected unless renewed or otherwise perfected under this Act.*

(4) *This perfection of a prior security interest that, when this section came into force, was covered by an unexpired filing or registration under a prior registration law, and for the perfection of which under this Act no registration of a financing statement is required, continues under this Act.*

(5) *A prior security interest that, when this section came into force, could have been, but was not, covered by a filing or registration under a prior registration law, may, subject to this Act, be perfected by the registration of a financing statement under this Act.*

(6) *A prior security interest that, when this section came into force, could have been, but was not, perfected under the prior law by the secured party's taking possession of the collateral, may, if permitted by this Act be perfected by such possession in accordance with this Act.*

(7) *A prior security interest that, under this Act, may be perfected by the secured party's taking possession of the collateral is perfected for the purposes of this Act by such possession, whether such possession occurred before or after this section came into force and notwithstanding that the prior law did not permit the perfection of the security interest by such possession.*

(8) *A prior security interest that, when this section came into force, could have been, bust was not, covered by a filing or registration under a prior registration law and which, under this Act, may be perfected without registration of a financing statement and without the secured party's taking pos-*

session of the collateral, is perfected for the purposes of this Act by the coming into force of this section, provided all the other conditions for the perfection of a security interest are satisfied.

(9) The time limit in subsection (3) does not apply to a corporate security.

Rules of practice.

66. Unless otherwise provided by this Act or the regulations, the Rules of Practice and Procedure of the ..... court apply to proceedings under this Act.

Destruction of documents.

67. Where books, documents, records, cards, or papers have been preserved for the purposes of this Act for so long that it appears they need not be preserved any longer, the Inspector of Legal Offices may authorize their destruction.

Conflicting provisions.

68. Where there is a conflict between a provision of this Act and a provision of [*a consumer protection Act*] the provision of [*such Act*] prevails and where there is conflict between a provision of this Act an a provision of any general or special Act, other than [*a consumer protection Act*] the provision of this Act prevails. (p . 315)

References to this Act.

69. The provisions of any general or special Act that relate to a security interest and that refer to the *Assignment of Book Debts Act*, the *Bill of Sale and Chattel Mortgages Act*, or the *Conditional Sales Act* or any provision thereof shall be deemed to refer to this Act or to the corresponding provision of this Act, as the case may be, and not to the *Assignment of Book Debts Act*, the *Bills of Sale and Chattel Mortgages Act*, or the *Conditional Sales Act*, as the case may be.

69. *The provisions of any general or special Act that relate to a security interest to which this Act applies and that refer to the* Assignment of Book Accounts Act, *the* Bill of Sale Act, *the* Conditional Sales Act, *or sections 73 to 82 of the* Companies Act, *as the case may be, and any reference to the Registrar-General appointed under the* Bills of Sale Act *shall be deemed to be a reference to the registrar of personal property appointed under this Act.*

Regulations.

70. The Lieutenant-Governor in Council may make regulations,

(a) designating branch offices;

(b) approving the form of the seal of the registrar and each branch registrar;

(c) prescribing the duties of the registrar and branch registrars;

(d) prescribing business hours for the offices of the registration system or any of them;

(e) respecting the registration system;

(f) requiring the payment of fees and prescribing the amounts thereof;

(g) prescribing the portion of the fees received under this Act that shall be paid into the Personal Property Security Assurance Fund;

(h) governing practice and procedure applicable to proceedings under this Act;

(i) prescribing forms and providing for their use;

(j) prescribing the particulars referred to in section 46;

(k) respecting any matter necessary or advisable to carry out effectively the intent and purpose of this Act

Expenses of administration.

71. The moneys required for the purposes of this Act shall be paid out of the Consolidated Revenue Fund until the ....., and thereafter out of such moneys as are appropriated therefore by the Legislature.

Commencement.

72. (1) This Act, except sections 1 to 40, 44, and 46 to 69, comes into force on the day it receives Royal Assent.

(2) Sections 1 to 40, 44, and 46 to 69 come into force on a day to be named by the Lieutenant-Governor by his Proclamation.

73. The Crown shall be bound by this Act.

74. This Act may be cited as the Uniform Personal Property Security Act, ...**.**

Appendix G—Other Transition Matters

A. Introduction

A large number of Provincial statutes, in some way, touch on the law relating to security interests in personal property. The most important of these have been considered in the chapter on transition. The purpose of this Appendix is to consider a number of others which raise particular problems.

A number of relevant statutes will pass without comment. Many Acts, for example, create statutory, or regulate common law, liens on chattels. The relationship of such liens to the PPSA is regulated by section 3 of the Act. Our version of the relevant provision reads:

> 3. This Act does not apply to
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> *(b)* a lien, charge, or other security interest given by statute, or a lien given by rule of law for the furnishing of goods, services, or materials, except as provided in section 32, paragraph *(b)* of section 36 (4) and paragraph *(b)* of section 37 (2).

The provisions referred to in section 3 *(b)* were discussed in Chapter XIII C.

We have made an exhaustive search of the Provincial statutes and have examined a large number of noncode liens. In each case the approach of the Model Act seems to work well and no modification of the lien statutes is necessary to accommodate section 3 *(b)*.

Other Acts contain references to one or more of the Acts or provisions thereof, to be repealed when the PPSA comes into full force. This situation is contemplated by the Model Act, and section 69 deals with it in general terms. Our version of section 69 provides:

The provisions of any general or special Act that relate to a security interest to which this Act applies and that refer to the *Assignment of Book Accounts Act,* the *Bills of Sale Act,* the *Conditional Sales Act,* or sections 73 to 82 of the *Companies Act* or any provision thereof shall be deemed to refer to this Act or to the corresponding provision of this Act, as the case may be, and not the *Assignment of Book Accounts Act,* the *Bills of Sale Act,* the *Conditional Sales Act,* or the *Companies Act,* as the case may be, and any reference to the Registrar-General appointed under the *Bills of Sale Act* shall be deemed to be a reference to the registrar of personal property appointed under this Act.

A number of Acts contain references to specific security devices, such as chattel mortgages, in contexts in which the broader PPSA notion of a "security agreement" would be more appropriate. Some of these are examined below as are a number of other problem areas.

B. Corporations Not Within the Companies Act

The *Companies Act* is not the only Provincial statute which provides for the incorporation of private bodies or which regulates their conduct. In some cases the applicable legislation has no special provisions relating to the registration of secured debt or priorities among competing interests. An example is the *Societies Act.*[1] In that case, the Acts of general application, such as the *Bills of Sale Act,* and the PPSA when it comes into force, would seem to apply automatically and no amendment to those incorporation Acts are necessary.

Other legislation such as the *Co-operative Associations Act, Credit Unions Act,*[3] *Trust Companies Act,*[4] and the *Companies Clauses Act* [5] provide for the registration and priority of such interests by incorporating, by reference, sections 73 to 82 of the *Companies Act.* The addition of transition provisions to the *Companies Act* as sections 82A and 82B and the subsequent repeal of sections 73 to 82B would seem to place credit unions, trust companies, co-operations, and special companies in the same position as other companies with respect to bringing them within the ambit of the PPSA.[6] It may be that greater clarity is called for in this respect, but this is a matter that can safely be left with Legislative Counsel.

It is not totally clear, however, that once the registration provisions of the *Companies Act* are repealed, the PPSA will apply to all security agreements within its scope which are created by such bodies. This should be put beyond doubt by an appropriate amendment to the relevant Act.

The *Railway Act* [7] contains its own unique provisions for the registration of railway securities. Section 138 provides:

138. (1) The company may secure such securities by a mortgage deed creating such mortgages, charges, and encumbrances upon the whole of such property, assets, rents, and revenues of the company, present or future, or both as are described therein; but such property, assets, rents, and revenu2s shall be subject, in the first instance, to the payment of any penalty then or thereafter imposed upon the company for non-compliance with the requirements of this Act, and next, to payment of the working expenditure of the railway.

(2) Every such mortgage deed shall, within fourteen days after the execution thereof, be registered with the Registrar of Companies in manner upon and by payment of the fees prescribed by the *Companies Act* in respect of the registration of mortgage deeds. No such mortgage deed shall require registration or be registered under the *Bills of Sale Act,* or any other Act in force respecting the registration of bills of sale.

(3) By the said mortgage deed, the company may grant to the holders of such securities, or the trustees named in such mortgage deed, all and every the powers, rights, and remedies granted by this Act in respect of the said securities, and all other powers, rights, and remedies not inconsistent with this Act, or may restrict the said holders in the exercise of any power, privilege, or remedy granted by this Act, as the case may be, and all the powers, rights, and remedies so provided for in such mortgage deed are valid and binding and available to the said holders in manner and form as therein provided.

(4) In order to preserve the priority of, or any rights conferred by, any mortgage, trust deed, or other instrument in the nature thereof issued, executed, or given by a railway company for the purpose of paying the principal and interest due to the holders of bonds or debentures issued by such railway company, without preference or priority, such mortgage, trust deed, or other instrument shall be filed in the office of the Registrar of Companies, and in like manner any agreement, or duplicate original thereof, entered into by any railway company shall also be filed in the said office; and a copy of such mortgage, trust deed, or other instrument or agreement so filed, certified to be a true copy by the Registrar of Companies, shall be received as prima facie evidence of the original in all Courts of justice in this Province without proof of any signature or seal upon such original, unless the authenticity of such signature or seal be called in question.

(5) In lieu of the original, or duplicate original, of any document referred to in this section, the Registrar of Companies may accept for filing a certified copy of any such document, and of the proof of its execution, verified by an affidavit made in accordance with the *Evidence Act* by either the president or the secretary of the company.

(6) The filing, according to the provisions of the preceding subsections, of any such mortgage, trust deed, or other instrument has the same effect as if such mortgage, trust deed, or other instrument had been registered under the *Land Registry Act.*

(7) The Registrar of Companies shall enter shortly in a separate index, to be called the "railway charge book," the particulars of every instrument filed under the provisions of this Act.

If Provincial railways are to be brought within the PPSA, distinct and complicated transition issues are raised. It may be that it is not worth bringing this very narrow range of security interests within the Act. There may also be policy arguments in favour of their exclusion.

Moreover, the approach taken to the *Companies Act* may not be the best way of bringing railway securities within the PPSA. The number of encumbrances involved might be small enough that they could be "transferred" to the PPSA registry as an administrative matter at an appropriate time. For the moment we favour leaving the *Railway Act* untouched.

C. Other Problems

1. THE DISTRESS ACT [8]

Sections 4 and 5 (1) of the *Distress Act* provide:

> 4. In all cases where a landlord distrains for rent on goods in the possession of his tenant, which goods are held by the tenant under a duly filed agreement for hire, contract, or conditional sale, the landlord shall sell only the interest of the tenant in the goods.
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> 5. (1) A landlord shall not distrain for rent on the goods and chattels of any person except the tenant or person who is liable for the rent, although the same are found on the premises; but this restriction does not apply
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> *(a)* in favour of a person claiming title under an execution against the tenant; or
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> *(b)* in favour of a person whose title is derived by purchase, gift, transfer, or assignment from the tenant, whether absolute or in trust, or by way of mortgage or otherwise; or
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> *(c)* subject to section 4, to the interest of the tenant in any goods or chattels on the premises in the possession of the tenant under a contract for purchase, or by which he may or is to become the owner thereof upon performance of any condition; or
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> *(d)* where goods or chattels have been exchanged between tenants or persons by the one borrowing or hiring from the other for the purpose of defeating the claim of or the right of distress by the landlord; or
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> *(e)* where the property is claimed by the wife, husband, daughter, son, daughter-in-law, or son-in-law of the tenant, or by any other relative of his, if such other relative lives on the premises as a member of the tenant∗s family, or by any person whose title is derived by purchase, gift, transfer, or assignment from any relative to whom the restriction does not apply.

These provisions do not raise a point of substance and no consequential amendment to them is necessary to accommodate the PPSA. The point is, rather, that, judged in their own terms, they are slightly odd in that they treat different kinds of security interests in different ways for the purpose of subjection to, or exemption from, the landlord's right of distress. In principle,

all property which is on the premises and is subject to a security interest should be treated in the same way for the purposes of exercise of the landlord∗s right of distress.

The present wording of the *Distress Act* suggests that the legal position is as follows:

(a) If a tenant is in possession of goods that have been pledged to him, there may be no distress at all (section 5 (1)):

(b) If a tenant is a conditional buyer of goods, the landlord may distrain the goods (section *5* (1) *(c)),* but only to the extent of the tenant∗s equity in them (section 4);

(c) If a tenant has mortgaged his goods, although the goods are now the property (technically speaking) of the mortgagee and hence fall within section 5 (1), they can still be distrained under section 5 (1) *(c),* and apparently the landlord may disregard the interest of the mortgagee (since section 4 does not protect mortgagees).

We suggest that sections 4 and 5 be redrafted. As a minimum, section 4 should be amended to provide that where goods subject to a security interest are in the possession of a tenant, the landlord may not dispose of any interest in those goods, by way of distress, other than the interest of the tenant.

2. THE MECHANICS∗ LIEN ACT

Section 48 of the *Mechanics∗ Lien Act* provides:

48. Where any charge, encumbrance, or mortgage on or claim to a motor-vehicle or aircraft is created and registered with the Registrar General after a garage-keeper has surrendered possession of the motor vehicle or aircraft and before the filing of an affidavit of lien in respect thereof, that charge, encumbrance, mortgage, or claim, if created in good faith and without express notice of the lien of the garage-keeper, has priority over that lien.

The references to "charge, mortgage, encumbrance, or claim" might be replaced by "security interest within the meaning of the *Personal Property Security Act."*

3. THE PAYMENT OF WAGES ACT[10]

Section 5A (1) of the *Payment of Wages Act* provides:

Notwithstanding any other Act, the amount of wages set forth in a certificate issued under section 5 constitutes a lien and charge in favour of the Board payable in priority over any other claim or right, including those of the Crown in right of the Province, and, without limiting the generality of the foregoing, such priority shall extend over every assignment, including an assignment of book debts, whether absolute or otherwise, every mortgage or real or personal property, and every debenture.

This provision could be strengthened by adding the words "and any other security interest as defined in the *Personal Property Security Act"* at the end.

4. THE PROVINCIAL HOME ACQUISITION ACT

The *Provincial Home Acquisition Act* was enacted to assist British Columbia residents in acquiring their own homes. The Act provides, *inter alia,* for grants of $1,000 in the case of a new home and $500 in the case of an older home.

It was foreseen by those who framed the Act that the grant system could be abused by persons acquiring and selling homes in rapid succession, pocketing a grant every time.

There were a number of ways in which this potential abuse could have been prevented. For example, grants could have been put on a once-in-a-lifetime basis. Rather, the drafters chose to introduce a certificate scheme. Section *5* of the Act presently provides:

5. (1) The Minister shall file in the Land Registry Office for the district in which the eligible residence in respect of which a grant has been made under this Act is situate a certificate showing that the grant has been made, the amount of the grant, the date of entitlement thereto, and a description of the land sufficient to identify the land on the records of the Land Registry Office.

(2) Where notice is received that a person who has received a grant under this Act has, before the expiration of five years from the date of entitlement to the grant, changed his occupancy to another eligible residence, the Minister shall

(a) file in the Land Registry Office for the district in which the eligible residence to which the person has changed his occupancy is situate a certificate showing that the grant has been made, the amount of the grant, the date of entitlement thereto, and a description of the land sufficient to identify the land on the records of the Land Registry Office; and

(b) file in the Land Registry Office in which the last certificate was filed under this section a cancellation thereof.

(3) Where a person repays in full to the Minister the amount of the grant made to him under this Act, the Minister shall file in the Land Registry Office in which the last certificate was filed under this section a cancellation thereof.

(4) Upon receipt of a certificate under this section, the Registrar shall without fee file the certificate and make a reference to it in the proper register against the title to the parcel or parcels of land to which the certificate relates, and until a cancellation of the certificate is filed in accordance with this section or the day following the fifth anniversary of the date of entitlement, whichever occurs first, the Registrar shall not allow registration of any transfer or conveyance of the fee-simple in the parcel or parcels, or any agreement to transfer or convey the fee-simple in the parcel or parcels, or any sublease or assignment of lease of the parcel or parcels, except in such cases as may be authorized by regulations.

A certificate filed in the Land Registry is not entered as a charge which is endorsed on the back of the certificate of title, but as a notation on its face.

It is clear that section 5 (4) operates as a direction to the Registrar of Titles that no voluntary conveyance or related transaction shall be registered so long as the certificate is in force. Does the registration of the certificate have any significance beyond that? Two questions in particular arise:

(1) Does the registration of a certificate create a security interest in land?
(2) Flow does registration affect an involuntary transfer as on death, bankruptcy, or foreclosure?

There is one reported case which is less than helpful. In *C.M.H.C.* v. *Adams* the plaintiff was a first mortgagee seeking foreclosure. C.M.H.C. had joined the Crown as a defendant hoping to nullify the effect of a notation of a certificate which had been placed on the title *after* registration of the mortgage. This was resisted by the Crown, which sought to have the service of the writ set aside. The Crown succeeded, apparently on two different grounds. The first was that a fiat to sue the Crown had not been obtained. Presumably this ground has disappeared with the enactment of the *Crown Proceedings Act*.

The second ground was stated by Morrow, L.J.S.C., as follows:

I agree that the $500 is a debt and that the purpose of sec. 5 (4) of the *Provincial Home-acquisition Grant Act is* to secure that debt to the Crown for a period of five years. It may view that the filing of B 18855 does not constitute a charge in the same sense that a mortgage does and that the Crown could not foreclose or be subject to foreclosure proceedings...
As the Crown has no equity of redemption in the land it should not be added as a party without the express permission of the Crown, which has not been obtained in accordance with the *Crown Procedure Act.*

The proposition that the $500 is a debt secured by registration cannot be reconciled with the proposition that the Crown has no equity of redemption and may not be joined in a foreclosure. Clearly that decision is wrong, but owing to the lack of guidance on the face of the legislation one can only speculate on the direction in which the error lay.

In 1973 a decision was taken to extend the grant scheme to the purchase of mobile homes. To this end the following provision was included in the *Mobile Home Tax Act* in 1973 (lst Sess.):

9. The owner of a mobile home that is assessable and taxable under this Act shall be deemed to be an owner of a parcel of land within the meaning of, and for the purposes of, the *Provincial Home-owner Grant Act* and the *Provincial Home Acquisition Act.*

In practice this has been taken as authority to make grants under the Act in respect of purchases of mobile homes. In 1973, section 5B was added to the *Provincial Home Acquisition Act:*

5B. (1) Notwithstanding section 5, a certificate issued in respect of a grant made under this Act in respect of a mobile home situated in a mobile home park, may be filed in the office of the Registrar-General and the Registrar-General shall, without charging any fee for filing or registration thereof, register the certificate under a distinctive number.

(2) Sections 2, 17, 18, 19, and 21 of the *Bills of Sale Act* apply to this section and, for the purpose only of the application of those sections, a bill of sale shall be deemed to include a certificate referred to in subsection (1).

The sections of the *Bills of Sale Act* incorporated are the definition section and the sections which relate to priorities and procedure.

This suggests that the certificate creates a security interest. But it is a strange sort of security interest. The Act provides no mode of enforcement and does not spell out the Circumstances which constitute a default on the part of the owner. Moreover, registration of a certificate under the *Bills of Sale Act* does not seem to preclude a voluntary transfer of the mobile home by the owner. This defeats the policy behind the certificate. One can only conclude that registration under section 5B is almost meaningless.

At the time of writing this Appendix there exists a public inquiry body charged with making recommendations relating to all aspects of mobile home ownership. Statements made to the press by that body suggest that among the recommendations will be a separate "mobile home registry." By that expression we understand an administrative registry comparable to that which exists for motor-vehicles under the *Motor-vehicle Act.*

In our view such a registry would provide a much more appropriate mechanism to implement Government policy on grants made with respect to mobile home purchases than the registration of a certificate under the *Bills of Sale Act.*

Essentially, every existing owner and "near owner" should be required to register his mobile home when the registration scheme is established. As new homes are sold by dealers they would be similarly registered. Each home would be given a number or some other appropriate designation to identify it for the purposes of the scheme. This would be done by a registrar.

Certificates of acquisition grants would be filed with the registrar of mobile homes who would refuse to register any transfer of a home if there is a certificate outstanding, except where the transfer is consequent on death, bankruptcy, or the enforcement of a security interest. This would be analogous to the motor-vehicle registry refusing a transfer where the sales tax or succession duties have not been paid.

In short, we do not feel that the registration of grant certificates should be carried forward into the PPSA registry and section 5B of the *Provincial Home Acquisition Act* should be repealed as soon as alternative machinery is established to record certificates.

5. THE THRESHERS∗ LIEN ACT[16]

Section 5 of the *Threshers∗ Lien Act* provides:

> The lien of the thresher under this Act has priority over all writs of execution against the owner of the grain threshed or cut and threshed, and over all chattel mortgages, bills of sale, or conveyances made by him, and over all rights of distress for rent reserved upon the land upon which the grain is grown.

That might be amended by replacing the words "chattel mortgages, bills of sale" with "security interests within the meaning of the *Personal Property Security Act."*

6. THE WAREHOUSEMEN∗S LIEN ACT

Section 4 (1) of the *Warehousemen∗s Lien Act* provides:

> Where the goods on which a lien exists were deposited not by the owner or by his authority, but by a person entrusted by the owner or by his authority with the possession of the goods, the warehouseman shall, within two months after the warehouseman has knowledge of the owner, give notice of the lien
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> *(a)* to the owner of the goods, including the person in whom the right of property therein is vested, where a valid receipt note, hire receipt, or other instrument evidencing a bailment or conditional sale of goods is filed under the *Conditional Sales Act* at the date of deposit; and
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> *(b)* to the grantee of the goods under any bill of sale or chattel mortgage registered under the *Bills of Sale Act* at that date.

This is an obscure provision which bristles with difficulties (e.g., what is meant by filing a bailment under the *Conditional Sales Act?* What is a "valid receipt note" or "hire receipt" and how is it filed? What is the significance of filing if the warehouseman must know the identity of the owner?)

The intent of section 4 (1) seems to be the establishment of a system whereby, if the person who deposited goods is not the true owner (and did not have the owner∗s authority), and if the warehouseman discovers the identity of the true owner, then the warehouseman must, if he wishes to assert his lien, notify the true owner within two months of discovering his identity. In this context, "true owner" seems to include any secured party and debtor within the meaning of the PPSA.

If we have correctly interpreted the intent of section 4 (1), then it might be replaced by a provision comparable to the following:

"Where goods subject to a warehouseman∗s lien were deposited by a person other than, and without the authority of, the owner, and if possession of the goods was entrusted by the owner or by his authority to that person, the warehouseman shall, within two months after he learns of the identity of the owner, give notice to the owner of his lien; and for the purposes of this subsection, and section 5 (2), owner includes any debtor or secured party within the meaning of the *Personal Property Security Act."*

We do not suggest here that registration of a security interest against the name of the person who deposited the goods should *per se* amount to "learning" of the secured party. The problem is to know when the two months start to run in such a case. Does it start from a time when the warehouseman begins to realize something is wrong? Or when any reasonable warehouseman should be put on notice? On balance, we feel the test should be actual knowledge. Owners should search out their goods rather than bailees their owners. In addition to modifying section 4 (1), a corresponding amendment should be made to section 5 (2).