LAW REFORM COMMISSION OF BRITISH COLUMBIA

REPORT ON DEBTOR-CREDITOR RELATIONSHIPS

(PROJECT NO. 2)

PART III DEFICIENCY CLAIMS AND REPOSSESSIONS

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

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TO THE HONOURABLE LESLIE R. PETERSON, 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 III DEFICIENCY CLAIMS AND REPOSSESSIONS

This Report has been prepared in the Commission's study on Debtor-Creditor Relationships which is Project No. 2 in the Commission's Approved Programme.

The rapid expansion of the volume of consumer credit in the Province of British Columbia in recent years has caused the Commission to direct its attention to the law governing deficiency claims and repossessions. While this is but one narrow aspect of debtor-creditor relationships, the Commission feels that the existing law does not adequately serve contemporary social needs and creates a situation which may invite abuse by the unscrupulous credit grantor.

In this Report the Commission puts forward recommendations which would, if enacted, have the effect of limiting and regulating the remedies available to the credit grantor who finances consumer purchases.

CHAPTER I INTRODUCTION

A virtually infinite variety of goods is available to today's consumer. The desirability of owning a wide range of goods is continually impressed on the consumer by the advertising media. The increased availability of consumer credit makes ownership a realizable goal. Today's level of consumer debt is unprecedented and a wider range of people is affected by the laws governing debtor-creditor relationships than ever before. The Commission is proceeding with a systematic analysis and evaluation of those laws and this Report is concerned with one particular aspect - the law concerning deficiency claims and repossessions.

The position of the credit grantor who is unsecured is less favourable than that of secured creditor, with regard to priorities and remedies. It follows that in situations where goods are sold and it is contemplated that the buyer will perform his obligation to pay the seller at some time in the future, the seller will wish to take security for the performance of this obligation whenever practical. That security usually takes the form of a security interest in favour of the seller in the goods themselves. The amount owing, the value and durability of the goods and the duration of the obligation will normally determine whether it is practical to take security. A variety of legal mechanisms are employed by the seller to obtain a security interest. Typical are the conditional sales agreement, which reserves legal title to the seller until payment in full, the chattel mortgage which gives the seller an enforceable charge on the goods, and the hire-purchase agreement under which the buyer's payments purport to be instalments of rent for the goods but which give the buyer an option to purchase the goods at a nominal sum at the end of the term of the "lease". The first two are common in British Columbia while the third is widely used in England. Such security agreements are broadly referred to as "time sale agreements".[1]

These security agreements normally provide that upon a default in payment by the debtor, the secured party may repossess the goods and sell them. The proceeds of the re-sale are credited to the debtor and applied to the balance owing by him under the security agreement. If that balance is still unsatisfied after re-sale, the amount by which it is unsatisfied is the so-called "deficiency claim. The present law in British Columbia permits the secured party to bring an action to claim the deficiency. This Report examines that law and its effects and makes a number of recommendations for reform in respect of both the substantive rights of the secured party and the procedure for enforcing those rights.

In May 1971 the Commission completed a working paper on the subject of this Report. That working paper was circulated for comment to a number of grantors of consumer credit, lawyers knowledgeable in the field of commercial law and groups concerned with consumer protection. All were asked to submit their written comment on and criticism of the proposals tentatively advanced by the Commission. Many responded and the comments and submissions received were of great value to the Commission in evaluating the tentative proposals and formulating the recommendations contained in this Report. In a number of instances, views expressed in the working paper have been revised or modified in the light of the response to the working paper.

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1. In this Report the Commission has adopted the terminology of *The Personal Property Security Act*, R.S.O. 1970, c. 344, and the terms, "security interest," "security agreement," "secured party" and "debtor" will be used throughout unless the context otherwise requires.

CHAPTER II THE PRESENT LAW - CONDITIONAL SALES

1. General

A "conditional sale" is defined in the *Conditional Sales Act*[1] as

> ... a contract
>
> (a) for the sale of goods under which possession is or is to be delivered to the buyer, and the property in the goods is to vest in him at a subsequent time upon payment of the whole or part of the price or the performance of any other condition ...

A conditional sale is one of the most commonly encountered forms of contract used in the sale of consumer durables, such as electrical appliances, as well as of more expensive items such as automobiles. So widely used is the transaction, indeed, that it falls into the category of "standard form contracts". Such a form may be obtained from any stationer selling legal stationery. Typically, the conditional seller agrees to sell goods on the condition that title to those goods will not pass to the buyer until the full purchase price, including all finance charges, has been paid by the buyer.[2] The buyer is given time in which to pay for the goods - a privilege for which he pays in the form of finance charges - while the seller has to wait for his money. In substance, if not in legal form, the seller is lending the buyer the purchase money, in return for the payment of "interest" on the loan. While the seller ensures a sale by making this accommodation, he is deprived of the present use of the outstanding balance of the contract price. Therefore, the seller will commonly assign the contract to a financing agency which will pay him a cash sum, suitably discounted, for the benefits of the contract. The original seller thus gets cash, while the financing agency is in effect substituted as the lender.

The financing agency acquires all the rights of the seller against the buyer. If the buyer fails to pay instalments, or meet some other obligation under the contract, the financing agency can enforce the contract as if it were the original party.

2. Remedies of Seller (or assignee)

The relationship of the seller or his assignee, and the buyer, under the conditional sale agreement, is at present, governed largely by the common law of sales, as modified by the *Conditional Sales Act.* The seller's remedies upon failure of the buyer to pay any instalment depend upon that law, and upon the terms of the contract entered into. It is almost invariably provided, however, that failure to pay an instalment constitutes a breach of condition[3] giving rise to any one of the

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1. S.B.C. 1961, c. 9, s. 2.

2. A typical conditional sales agreement provides: Said motor vehicle and all parts and accessories added thereto, either as additions thereto or in substitution for existing parts or accessories, is now and shall remain the absolute property of the Seller until after full and complete payment of the above mentioned total sum and interest.

3. A typical provision states: Time shall be material and of the essence hereof, and if default be made in the payment of said principal sum or interest, or any part thereof, at the time the same shall become due, or if he shall in any way at any time fail to fully observe and perform any covenant or covenants herein contained or shall sell or dispose of said motor vehicle or interest therein or part with possession of same or fail to keep same insured or make default in any condition or agreement herein contained, or if said Buyer fails to make payment for any labour, repairs, improvement or equipment

remedies discussed below.

(a) Action for the price

At common law, the seller has a right to hold the buyer to the contract and to sue for each instalment as it falls due,[4] provided of course, that he is willing and able to perform his part of the bargain by delivering possession[5] of the goods. It is standard practice for a conditional sale contract to include an acceleration clause; such a clause permits the seller, upon the buyer's failure to pay any instalment, to declare the full contract price[6] due and payable.

(b) Repossession of the goods

Conditional sales agreements invariably provide that if the buyer defaults, the seller or his assignee may reclaim possession of the goods, and either retain or sell them.[7] The seller's right to repossess is not restricted in any way, and may be exercised upon any default by the buyer, be it in payment of the first instalment of the price, or the last.

Repossession of the goods and an action for the contract price are not necessarily mutually exclusive remedies. If a seller of goods wishes to sue for the price, he must be in a position to deliver the goods he has sold, since, by suing for the price, he elects to affirm the contract, and he must therefore perform his obligations under it.[8] Under a conditional sale, however, the goods are transferred into the possession of the buyer. If, upon the buyer's default, the seller has repossessed the goods, he must be prepared to redeliver them to the buyer if he decides to claim the contract price. The mere fact that the goods have been repossessed, therefore, does not of itself preclude an action for the price, provided that the seller is willing to redeliver them.[9] If, on the other hand, the seller has sold the repossessed goods instead of merely retaining them, he must be taken to have made an election to rescind the agreement. He is unable to deliver the goods in accordance with the contract and, in the absence of some provision in it authorizing him to make a claim for the price in these circumstances, is unable to satisfy an essential prerequisite of such an action at common law.[10] The contract may, however, include a "deficiency clause." That is a provision to the effect that the

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placed upon the said motor vehicle by authority of said Buyer (in which case said Seller may, at its option, make such payment) then the said principal sum and all accrued interest, including expenses (if any) and including such payment (if any) made by said Seller thereon, shall thereupon immediately become wholly due and payable at the option of said Seller, the said Seller may at once take possession of said motor vehicle and said parts, devices, tools and equipment wherever the same may be, and sell said motor vehicle and said parts, devices, tools and equipment and the whole thereof, as provided by law.

4. *Maxwell Radio Co.* v. *DeWilde*, [1931] 2 D.L.R. 123; *Workman, Clark & Co., Limited* v. *Lloyd Brazileno*, [1908] 1 K.B. 968. Cf. *Sale of Goods Act*, R.S.B.C. 1960, c. 344, s. 53(2).

5. *Maxwell Radio Co.* v. *DeWilde, supra* note 4.

6. *See* example *supra* note 3.

7. *Ibid.*

8. *Maxwell Radio Co.* v. *DeWilde, supra* note 4.

9. *McNutt* v. *Alexander Fraser Ltd.*, (1960), 23 D.L.R. (2d) 236.

10. *Humphrey Motors Ltd.* v. *Ells*, [1935] S.C.R. 249; *Construction Equipment Co.* v. *Knott*, (1963), 39 D.L.R. (2d) 765.

exercise of the power of resale on repossession does not affect the seller's right to claim the balance of the contract price.[11]

In recognition of the fact that the practice of repossession and resale was capable of abuse in the hands of unscrupulous vendors, the legislature intervened to control the procedure for repossession. The relevant statutory provisions are now contained in section 14 of the *Conditional Sales Act*. These provisions do not purport to restrict the right of repossession. They focus, rather, upon the right of resale. In essence, they impose a waiting period upon the seller who has repossessed, during which the buyer is given a limited opportunity to remedy his default and recover the goods.

Section 14(1) provides that where the seller repossesses goods, he must

> ... retain them for twenty days, and the buyer may redeem the same within that period by paying or tendering to the seller the balance of the contract price, together with the actual costs and expenses of taking and keeping possession, or by performance or tender of performance of the condition upon which the property in the goods is to vest in the buyer and payment of such costs and expenses, and thereupon the seller shall deliver up to the buyer possession of the goods so redeemed.

The buyer thus has twenty days within which to recover possession of the goods. The legislation clearly requires the buyer to pay or tender the balance of the contract price. After the expiry of the twenty-day period, it seems, the buyer loses his right to recover the goods, being treated as having repudiated the contract through failure to pay on time. It should be noted, in passing, that the court has power to review the expenses chargeable[12] to the buyer as a result of a seizure and sale. Section 14(2) provides, *inter alia*, that "when the goods are not redeemed within the period of twenty days ... the seller may sell the goods, either by private sale or at public auction, at any time after the expiration of that period."[13]

(c) Deficiency claims

It follows from the fact that a sale of the goods after repossession amounts to a decision by the seller to treat the contract as at an end, that he is debarred from suing on the contract to claim any difference between the contract price and the proceeds of sale plus payments already made by the buyer. In principle, however, it would seem that, at common law, the seller should have an action for damages for breach of contract. In practice, the problem is dealt with in the contract itself. Conditional sale agreements invariably specify that if the goods are repossessed and resold with a deficiency remaining, the buyer shall be responsible to pay that deficiency.[14]

The exercise of the seller's contractual right to claim the deficiency from the

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11. *General Securities Ltd.* v. *Lyons*, (1957), 8 D.L.R. (2d) 652.

12. *C.E.R. & S. Credit Union* v. *Brown*, (1969), 4 D.L.R. (3d) 95.

13. Section 14(8) of the *Conditional Sales Act* contains special provisions governing the sale of repossessed automobiles by public auction.

14. A typical deficiency clause states: The Buyer agrees to pay any deficiency that may remain after the application of the proceeds of any sale hereunder to the payment of said indebtedness, or any judgment obtained thereon. The Buyer shall not be entitled to any accounting whatsoever in respect of any such sale, nor shall any action lie for that purpose.

buyer is subject to certain statutory limitations, set out in section 14 of the *Conditional Sales Act*. If the seller intends to resell after the twenty-day period has elapsed and claim the deficiency, he must give notice to the buyer in the form prescribed by the Act.[15] The giving of this notice is a condition precedent to any claim for a deficiency, and the courts have insisted on strict compliance with the statutory requirements, the merest technicality of non-compliance having been held sufficient to defeat such a claim.[16]

3. Entitlement to Surplus on Resale

It is possible that the proceeds of resale by the seller will exceed the unpaid balance of the price. In this case, of course, while there will be no question of a deficiency claim, there is a question as to who is entitled to the surplus thus realized.

At common law, as has been noticed, resale by the seller is frequently held to constitute rescission[17] of the agreement. It could be argued, therefore, that the buyer loses all further interest in the goods and cannot claim any part of the surplus arising on resale. This, at least, appears to be the position in relation to ordinary contracts of sale, for section 52(4) of the *Sale of Goods Act*[18] provides that

> Where the seller expressly reserves a right of resale in case the buyer should make default, and on the buyer making default resells the goods, the original contract of sale is thereby rescinded, but without prejudice to any claim the seller may have for damages.

The provisions of the *Sale of Goods Act* apply to conditional as well as unconditional sales,[19] and it might be thought, therefore, that section 52(4) would operate to deprive the conditional buyer in default of any claim to a surplus, unless excluded in accordance with the Act. There is, however, high authority for the view that, at least where there is a deficiency clause in the agreement, a surplus arising on resale belongs to the buyer and not the seller. In *C.C. Motor Sales Ltd.* v. *Chan*,[20] the buyer defaulted under a conditional sale agreement which contained a clause providing that "the purchaser agrees to pay any deficiency that may remain after the application of the proceeds of any sale hereunder to the payment of said indebtedness or any judgment obtained thereon". The Supreme Court of Canada held that the purchaser was entitled to the surplus realized on resale. The rationale of the decision appears to be that the existence of a deficiency clause converts the conditional sales agreement into a security agreement closely analogous to a chattel mortgage.[21] In the case of a chattel mortgage, it is clearly established that the mortgagor is entitled, as owner of the goods in equity, to any surplus realized on resale by the mortgagee. The essence of the Supreme Court's judgment in the *Chan* case is contained in the

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15. Section 14(4).

16. *See, e.g., Speedway Motors Ltd.* v. *Davies*, (1952), 35 D.L.R. (2d) 501; *Industrial Acceptance Corporation* v. *Shiels*, (1969) 71 W.W.R. 641; *LaBelle* v. *Traders Finance Corp.*, (1957) 9 D.L.R. (2d) 275. Cf. Note *Conditional Sales Deficiency Notices*, (1960) 9 Chitty's L.J. 250, 261.

17. *See* authorities cited in notes 8-10, *supra*.

18. *Sale of Goods Act*, R.S.B.C. 1960, c. 344.

19. *Sale of Goods Act*, R.S.B.C. 1960, c. 344, s. 8(2).

20. [1926] S.C.R. 485.

21. Cf. *Sawyer* v. *Pringle*, (1891) 18 O.A.R. 218.

following passage.[22]

> The debt is secured upon the property, the legal ownership remaining with the creditor, but the equitable ownership being that of the debtor, subject to the security afforded to the creditor for the debt; the vendor is given the right to take possession and sell, if the purchaser failed to make payment; the proceeds of the sale are to be applied to the payment of the indebtedness, and the purchaser is to pay any deficiency which may remain; therefore the relationship between the parties does not differ essentially from that of mortgagor and mortgagee with an obligation for payment by the former; and if, as I conclude, that be the meaning and effect of the instrument, there can be no doubt that the surplus proceeds of the sale belong to the purchaser. It is true that the property was not transferred to the purchaser and re-conveyed to the vendor in order to effect the security for the indebtedness which, by the stipulations of the agreement, the latter was to have; but equity looks to the intent of the transaction rather than to the form, and the intent is made clear by the terms of the instrument.

While the decision in the *Chan* case might be regarded as something of an anomaly so far as the law of sales is concerned, and has rarely been applied in subsequent cases,[23] in practice most conditional sellers and their assignees usually do in fact turn surpluses over to the buyer, and express provision to this effect is frequently included in the conditional sale contract.[24]

If the conditional sale contract does not include a deficiency clause, it would be more difficult for the court to make the analogy with a security arrangement, and the buyer will only be able to assert a claim to the surplus on some other equitable ground.[25]

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22. [1926] S.C.R. 485, 491.

23. But *see Won Wah Law Co.* v. *Wong*, [1962] O.W.N. 165.

24. But this is not always the case. A form of conditional sales agreement included in the working paper as Appendix A specifically provided that the seller should be entitled to any surplus.

25. *See, e.g., Re Stanley & Bunting*, [1924] 3 D.L.R. 599; cf. *Kilmer* v. *B.C. Orchard Lands, Ltd.*, [1913] A.C. 319.

CHAPTER III THE PRESENT LAW - CHATTEL MORTGAGES

1. General

Another way in which a seller of goods who is not to receive immediate payment in full of the purchase price may attempt to secure himself against the consequences of the buyer's failure to pay, is by recourse to an out-right unconditional sale, together with a collateral mortgage back of the goods sold.[1] The legal relationships generated by a mortgage of chattels do not differ in any respects material to this Report from the more commonly known mortgage of land. In both cases, the effect of the transaction is to vest in the seller (the mortgagee) the legal ownership of property, the equitable ownership of which is vested in the buyer (mortgagor) who, almost invariably, is also In possession of that property. The practical effect of a sale and mortgage back of chattels is similar to that of a conditional sale. In both cases, the seller is left with the legal ownership of the goods sold.

A mortgage transaction creates two different sets of legal relationships. On the one hand, it involves a personal undertaking by the mortgagor to pay the principal sum lent, together with interest. On the other hand, it gives the mortgagee a security interest in the property mortgaged or, to put it differently, it confers upon the mortgagee certain rights against that property by way of security for due performance of the personal undertaking of the mortgagor.

At common law, the rights and obligations of the parties to a mortgage were strictly construed. The common law courts concentrated upon the purely contractual aspects of the arrangement reflected in the mortgagor 's undertaking to repay the money lent. If he failed to pay any instalment of the price, he was in breach of contract, and immediately lost any right to reclaim the legal ownership of the goods mortgaged. Correspondingly the mortgagee, being the absolute legal owner of the goods sold, could if he wished sell those goods in satisfaction of his debt.[2] So far as the common law courts were concerned, the point in time at which the mortgagor's default occurred, was irrelevant, as was the relationship between the value of the goods mortgaged and the size of the debt outstanding. For the mortgagor, therefore, a failure to perform strictly the repayment obligations he had undertaken could be disastrous. Not only did he lose the benefit of any payments he had made, but he also lost the property mortgaged, a result especially severe where the value of the security substantially exceeded the size of the debt.

2. Mortgagor's Equitable Right to Redeem

To ameliorate the harshness of the common law rules, equity intervened by, in effect, superimposing upon the legal rights and obligations created by the mortgage, certain equitable rights which could not be avoided by any terms of the agreement. Of these, the most important was a term that, although the mortgagor's right to redeem may have become forfeited at common law by reason of non-payment, he would nevertheless have an equitable right to do so.[3] In other words, equity would

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1. The chattel mortgage is also a "standard form agreement" which is available at any legal stationers.

2. *See generally* Falconbridge, *The Law of Mortgages of Land*, § 12 (3 ed. 1942).

3. *See* generally Falconbridge, *supra* note 2, at 32-36; *Hanbury's Modern Equity* 544-546 (9 ed. 1969).

allow the mortgagor to redeem the property by paying the unpaid balance of debt, even though at common law he had lost his right to do so.

While the intervention of equity on behalf of the mortgagor clearly eased his position, it was equally clearly unfair to the mortgagee who was left in a state of uncertainty as to whether he could rely on his legal ownership of the property, reclaim possession of it, and, if necessary or desirable, resell it in satisfaction of the debt. He was placed at risk, as it were, that his legal right to reclaim possession of the goods and resell them, might be defeated by the exercise of the equitable right of the mortgagor to redeem. Moreover, the mortgagor's right to redeem was not subject to being barred by the operation of any statutory period of limitations, though it might be lost by acquiescence, or through the operation of the equitable doctrine of laches.

3. Foreclosure

But equity was nothing if not even-handed, and, to balance the positions of the parties, it conferred upon the mortgagee an equitable right to obtain what is known as an "order of foreclosure," that is, to insist that[4]

> ... the mortgagor who has made default at law should either exercise his equitable right to redeem within a reasonable time or be forever precluded from exercising it.

The effect of a foreclosure order, generally,[5] speaking, is to extinguish the mortgagor'[5] equitable right to redeem. Since that is all that the mortgagor has - the legal ownership being in the mortgagee - his rights in the property mortgaged are completely eliminated, and the mortgage itself is completely wiped out. The property itself becomes vested absolutely in the mortgagee, who may either keep it, or sell it.

4. Deficiency Claims and Surpluses

If the mortgagee elects to obtain a foreclosure order he is not thereby precluded from claiming anything further from the debtor. He can still sue on the personal covenant to pay, or if he obtained a judgment for payment as well as foreclosure he can still execute. Such further proceedings; however, have the effect of re-opening the foreclosure and the mortgagor acquires a new right to redeem, thus further proceedings can be taken only if the mortgagee would be able to re-convey the property should the mortgagor wish to exercise this fresh right to redeem.[6] In practice, foreclosure will be sought only when the value of the mortgaged property exceeds the debt so it will not be in the mortgagee's interest to take steps which will re-open the foreclosure. Further proceedings are therefore very rare.

If it is apparent that the property itself greatly exceeds in value the unpaid balance of debt, the court, in a foreclosure application, may decline to grant a foreclosure order. Since it is exercising an equitable jurisdiction, it may refuse to

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4. *Ibid.* at 36. *See also ibid.* ch. 24.

5. The mortgagor is under certain extraordinary circumstances permitted to redeem even after a foreclosure order absolute has been made, for instance where the mortgagee has taken steps which causes the foreclosure to be re-opened. See *infra* note 6.

6. *See* Falconbridge, *supra* note 2, 453 *et seq.*; cf. *Land Registry Act*, R.S.B.C. 1960, c. 208, s. 199(4).

eliminate the mortgagor's interest and choose instead to order that the property be sold subject to judicial supervision. The order of sale does not affect the mortgagor's personal undertaking to pay, which remains in existence. The proceeds of sale are held in trust for the mortgagor to the extent of any amount realized that is surplus to the outstanding indebtedness.

Foreclosure actions under chattel mortgages are rare. If there is any prospect of a deficiency remaining after resale, the mortgagee would not wish to bar himself from the opportunity to claim the deficiency. If, on the other hand, the resale would produce a surplus, the court may refuse to order foreclosure. Moreover, two court applications are required. Under modern practice, the mortgagee must first obtain what is referred to as a foreclosure order *nisi*, which is, in effect, a conditional order, the condition being the failure of the mortgagor to redeem the property within a time fixed by the court. Upon such failure, the mortgagee must make a further application to have the conditional order declared absolute - that is, to extinguish finally the mortgagor's interest. Foreclosure proceedings are costly, and in relation to the amounts involved in most consumer transactions, uneconomical.

5. Contractual Power of Sale

In general, it is much simpler and much cheaper and it has become commonplace - for the mortgagee to insert a clause into the chattel mortgage expressly reserving to himself a contractual right to repossess and resell the property if the mortgagor defaults.

A chattel mortgagee acting under a contractual power of sale, can repossess and sell immediately upon default by the mortgagor.[7] He is not subject to any waiting period, as is a conditional seller under the *Conditional Sales Act*. Moreover, the exercise of a contractual power of sale does not terminate the agreement, and, if any deficiency remains, the mortgagee is free to recover it from the mortgagor. This is so, whether or not the agreement makes any specific reference to deficiencies, and flows from the fact that the exercise of the contractual power of sale is an act done pursuant to the agreement, and consistently with it, and therefore does not affect the mortgagor's personal undertaking to pay the full contract price. Correspondingly, since the mortgagor remains the equitable owner of the goods, he is entitled to any surplus resulting from a resale. Moreover, unless the mortgagee acts quite improvidently in selling the goods, it will be extremely difficult to establish that he has been guilty of any breach of duty towards the mortgagor.[8] The exercise of the power of sale, therefore, is generally much more expeditious and attractive for the mortgagee than a foreclosure order.

When a chattel mortgagee repossesses the goods pursuant to his rights under the agreement, the mortgagor is not thereby deprived of his right to redeem which ... exists so long as the mortgagee has possession and until by legal sale of the goods or foreclosure he cuts off the equity of redemption." [9]

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7. Cf. *Sawyer* v. *Pringle, supra* note 21 (part II); but cf. *West City Motors Ltd. & Leslie* v. *Delta Acceptance Corp.* [1963] 2 O.R. 683.

8. *See generally J. & W. Investments Ltd.* v. *Black*, (1963) 38 D.L.R. (2d) 251; *B.C. Land and Investment Agency* v. *Ishitaka*, (1912) 45 S.C.R. 302; *Cruickshank* v. *Murphy Campbell Co.*, (1958) 13 D.L.R. (2d) 250 is a good example of the generous treatment accorded to a mortgagee in the exercise of his power of resale.

9. *Barron on Bills of Sale*, 252 (2 ed. 1888).

CHAPTER IV AN ANALYSIS OF THE PROBLEM

The present law may be summed up as follows: Immediately upon the default of the debtor, the secured party under a security agreement may repossess the goods, resell them and sue the debtor for any deficiency balance owing. If the transaction takes the form of a conditional sale agreement, the secured party is subject to two restrictions: He must allow 20 days to elapse between a repossession and a resale and give notice to the debtor of his intention to claim a deficiency. The Commission feels that this is a situation which is capable of imposing undue hardship on the consumer and which invites abuse by the unscrupulous seller or his assignee.

Perhaps the greatest potential abuse lies in the resale itself after repossession. So long as the secured party has a right to judgment for a deficiency his incentive to obtain the best possible price on resale is very limited. The only factors which might prompt him to maximize the resale price would be the fear that the deficiency might prove to be uncollectible or the fact that he would receive more money now rather than later. The force of these factors must necessarily vary from case to case.

The fact that there is no requirement that the repossessed goods be sold by public auction provides a positive inducement to the unscrupulous secured party to obtain a low price where it appears a deficiency may be collectable. This abuse is the so-called "sweetheart deal." If the person buying the repossessed goods is also a dealer in those goods, the lower the price paid the greater is his margin of profit. An agreement may, therefore, exist between two sellers whereby each buys the repossessions of the other at an unrealistically low price thus increasing the profits of both at the expense of the original buyers. The possibility also exists that the secured party and the buyer of repossessed goods may be affiliated such as the case where the secured party incorporates a company for the specific purpose of buying his repossessions and selling them at a profit. While the credit grantor who engaged in such practices may run the risk of having a court give relief to the buyer in individual cases, the Commission believes that such a scheme would show a substantial overall profit.

The potential loss to the debtor is even greater if repossession occurs late in the term of the contract. If the debtor defaults at that time, he will have paid most of the contract price and the goods will likely be worth considerably more than the balance owing on the contract. Here the temptation is even greater to sell the goods to a "sweetheart" for the balance owing as there is no need to pursue the deficiency claim. Alternatively, the conditional seller may be tempted to sell the goods at the higher, more realistic price and pocket the balance taking his chances on the buyer pursuing a claim for that surplus under the principles laid down in the *Chan* case. Many time sale contracts contain so-called "balloon payment" provisions which provide for extra large payments late in the term of the contract.

In theory, the resale procedure should be policed by the debtor through his right to redeem. The Commission feels that the value of the right to redemption as a policing mechanism is minimal if not non-existent. Security agreements normally provide that in order to redeem the debtor must tender to the secured party the full balance of the contract price owing plus the costs of the repossession. The debtor who is in default will likely be unable to raise the funds necessary. In addition the debtor who has had his goods repossessed is not likely to be anxious to have any further involvement with the secured party. An even greater obstacle in the path of

the debtor is that he may not know that he has a right to redeem. There is no requirement that the secured party who has repossessed give notice to the debtor of his right to redeem, except in the case of a conditional sale where the seller intends to make a deficiency claim. This omission has, in the Commission's opinion, been justly criticized as

> ... unfortunate because the buyer may be anxious to redeem or reinstate the agreement even if no claim to a deficiency arises, as where the value of the repossessed goods exceeds the balance outstanding under the agreement. It is illogical in such a case to give the buyer a statutory right of redemption without making provisions which will ensure that the existence of this right is brought to his notice after the goods have been repossessed and that he is informed of the steps he has to take to exercise the right and the time which is available for him to do so.[1]

A further difficulty faced by the chattel mortgagor who wishes to redeem is the lack of any fixed redemption period. The conditional seller must retain the goods for 20 days but the chattel mortgagee may resell immediately. While the six-month redemption period traditionally given in land foreclosure actions may be inapplicable in the case of goods, the value of which is subject to depreciation, the lack of any period for the redemption of chattels by a mortgagor is highly inequitable.

The right to redeem is not the only right which a buyer in default has. Section 18 of the *Consumer Protection Act* provides as follows:

> Where, having regard to all conditions and circumstances of an executory contract, or a borrowing transaction, and the state of account between buyer and seller, or borrower and lender, it is shown that the exercise of the seller's or lender's rights against a buyer or borrower in default is harsh and unconscionable, or otherwise inequitable, the Court or a Judge may impose terms and conditions upon the parties to the executory contract, or borrowing transaction, so as to relieve against an inequitable exercise of legal rights by the seller, or lender, or avoidable loss to either party.

This provision appears to give the courts fairly wide powers to control the seller's exercise of his right of repossession. At present there is no requirement that the buyer be given notice that those powers exist.

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1. Goode & Ziegel, *Hire Purchase & Conditional Sale: A Comparative Survey of Commonwealth & American Law* 121 (1965)

CHAPTER V THE EXTENT OF THE PROBLEM

The working paper pointed out that it is extremely difficult to obtain factual information concerning repossession and resale. The Commission is not aware of any reliable empirical studies in Canada. In this part of the Report the Commission must therefore rely on specific incidents brought to its attention, informal enquiries, and the experience of other jurisdictions.

1. Sale after Repossession and Sweetheart Deals

A recent study in California disclosed that the average resale price of automobiles was only 51 per cent of the Red Book retail value, and that a second sale took place on the average 147 days after repossession, at a price at about 92 per cent of Red Book value.[1] The relatively short time between the resale and the second sale coupled with a significant increase in price is highly suggestive of a high incidence of sweetheart deals.

The records maintained by the British Columbia Motor Vehicle Branch are not arranged in a system permitting records of sales after repossession to be readily identified and extracted, hence, a study analogous to that made in California is not easily carried out. The Commission has no reason to believe that conditions governing repossession and resale in California are significantly different from those encountered in British Columbia. While the California figures may not reflect the situation in British Columbia with complete accuracy, the Commission feels justified in concluding that the incidence of unrealistically low resale prices is sufficiently great to warrant its attention.[2]

2. Incidence of Deficiency Claims

It was pointed out in the working paper[3] that in practice default followed by repossession, when it occurs at all, generally occurs very early in the life of a time sale contract. Since it is during this period of time that the value of new consumer goods depreciates most rapidly, it follows that the right to make a deficiency claim exists in the majority of cases where goods are repossessed. The extent to which such claims are successfully collected is difficult to assess.

Court records in British Columbia are not indexed or organized in a fashion which permits the incidence of deficiency claims to be accurately ascertained. Informal discussions with Judges and Registry officials lead the Commission to believe that such proceedings are no longer as common as they once were. Recent amendments to the *Small Claims Act*[4] and *Supreme Court Rules*[5] have eliminated the default judgment. The practice now appears to be that where the defendant in a deficiency claim action is in default of appearance, the plaintiff takes proceedings analogous

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1. Schuchman, *Profit on Default: An Archival Study of Repossession and Resale* (1969) 22 Stanford L. Rev. 20.

2. Specific examples of such practices have been brought to the attention of the Commission.

3. Working paper, para. 33.

4. R.S.B.C. 1960, c. 359 as amended by S.B.C. 1965, c. 49, s. 4(c).

5. B.C. Reg. 91/70.

to an interlocutory judgment and the claim is set down before a Judge for assessment. It is estimated that in Vancouver such claims are set down at the rate of one or two per week in the Supreme Court, four to five per week in the County Court and two to three per week in the Small Claims Division. These figures will include commercial as well as consumer transactions and claims where debts other than purchase money was secured. The amendments referred to appear to be largely responsible for this relative paucity of such claims. A Vancouver Small Claims Registry official said of the amendment:[6]

> ... when this was first initiated in the Small Claims Court there were quite a large number {of deficiency claim actions) on the lists but as the plaintiffs became aware of the procedure they do not seem to be suing where an Interlocutory may have to be issued.

Legal process is not the only method of effecting collection where a deficiency exists. The effect of the procedural hurdles in pursuing such claims through the courts may have resulted only in potential plaintiffs adjusting their collection policies by placing greater emphasis on extra-judicial coercion and greater employment of collection agencies.[7]

3. Conclusion

A number of those respondents to the working paper commented on the absence of any independent empirical investigations to support the Commission's proposals. One responded.[8]

> I am somewhat troubled by the absence of information or data establishing a degree of prevalence of the harm to be remedied which degree would in fact warrant the remedy. One concludes that your answer would be that the nature of the remedy eliminates only harmful conduct and otherwise works no prejudice ... If I am correct in the foregoing, one hopes that you are right.

This is a legitimate comment on the Commission's approach; however for the purposes of this Report we feel that empirical research, while desirable, is not necessary. It has been demonstrated that a situation exists which is capable of being abused; experience in other jurisdictions indicates that such abuse is in fact occurring; and individual examples of abuse and hardship have come to the attention of the Commission. A lack of empirical research should not deter the Commission from recommending reforms which it is satisfied will visit no substantial inequity on credit grantors, but will alleviate some of the inequities which the existing law imposes on the consumers of credit.

The Commission feels and has sought to demonstrate that there are elements in the existing law of the Province that may encourage the unscrupulous to extend credit and which correspondingly tempt the ignorant, foolish or ill-advised to seek it and so enable the former to line his pockets at the expense of the latter. The Commission has concluded that remedial measures are both desirable and necessary, and is fortified in this conclusion by the fact that a substantial number of other jurisdictions have taken action in connection with the problems discussed in this

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6. Contained in a letter to the Commission dated May 11, 1972.

7. *See* Law Reform Commission of British Columbia Report on *Debtor-Creditor Relationships*, Project No. 2, Part I *Debt Collection and Collection Agents.*

8. Contained in a letter to the Commission dated July 16, 1971.

Report.

CHAPTER VI THE COMMISSION'S RECOMMENDATIONS

In the Commission's view, any alteration of the law relating to repossession and deficiency claims should achieve, *inter alia* the following objects:

(1) It should modify the repossession and re-sale procedure to eliminate potential abuse.

(2) It should discourage the extension of credit to the "high risk" debtor who is likely to default.

(3) It should give all debtors in default an adequate opportunity to redeem and notice of the right to redeem.

(4) It should give the debtor notice of the court's jurisdiction to give relief from a repossession which is harsh and unconscionable.

The Election of Remedies Principle

The Commission has concluded that an appropriate method of achieving these aims lies in restricting the remedies available to the secured party. This has been done in other jurisdictions in Canada. The remedial legislation falls into two broad categories:

(a) Restriction of the Remedies of the Secured Party to the Enforcement of his Security

This is the most restrictive approach that can be taken. It has in fact been adopted in Saskatchewan under the *Limitation of Civil Rights Act*.[1] By section 18(1) of that Act, where an article is sold for more than $100, and the seller retains a lien on that article for the price, his right to recover any unpaid balance of the price is restricted to whatever is realized upon repossession and resale. By section 19(4), this limitation applies to all instalment sales, whether by way of conditional sale, or by way of a promissory note accompanied by a chattel mortgage, and, subject to some exceptions listed in section 18(2), including mining machinery and machinery used in petroleum and natural gas exploration and production, applies no matter what the subject-matter of the agreement may be.

Where the secured party repossesses, or the goods are surrendered to him by the debtor, "the indebtedness of the purchaser in respect of the purchase price is extinguished."[2] The limitation does not apply, however, where the article sold is totally destroyed or where a court, having been satisfied that the article sold has been wilfully or by the neglect of the buyer, or that it is otherwise inequitable that the limitation should apply, so orders.[3]

(b) Requiring the Secured Party To Elect Between Enforcing his Security or Suing on the Debt

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1. R.S.S. 1965, c. 103.

2. *Ibid.*, s. 18(5).

3. *Ibid.*, s. 18(7).

This is the approach that has been adopted in Alberta,[4] Manitoba,[5] and Newfoundland.[6] By section 19 of the Alberta *Conditional Sales Act*, a seller of goods who lends purchase money under a conditional sale agreement or chattel mortgage is, upon default by the buyer in payment of the price, required to elect between repossessing the goods or suing for the purchase price.[7] Section 19 of the Alberta *Conditional Sales Act* is set out in full as Appendix A to this Report. If the secured party chooses to repossess, he may recover the proceeds of sale of the goods after repossession only, and "no action is maintainable for the purchase price or any part" thereof.[8]

If, on the other hand, the secured party chooses to sue for the price and recovers judgment, then, by section 19(4),

> ... if the goods in respect of which that money is owing are seized under an execution issued pursuant to that judgment, the seller's rights are restricted to the amount realized from the sale of those goods and the judgment, to the extent that it is based upon the purchase price of those goods and chattels ... shall be deemed to be fully paid and satisfied.

The effect of section 19(4) is that, if a secured party wishes to get the full advantage of his judgment for the price, he must ensure that the goods seized in execution of the judgment do not include those originally sold. If the goods sold are seized and resold in execution, the secured party is placed in exactly the same position as if he had repossessed, and will be allowed to recover only so much as is realized on the resale of the goods originally sold. The purpose of this provision is obvious. If there were no such limitation upon executing a judgment for the price, the secured party could effectively circumvent the limitation imposed upon his right of repossession, and the election required by the legislation would be rendered nugatory. Where the debtor's assets are roughly evenly distributed between the goods sold and his other assets, the effect of section 19(4) is, of course, to force the secured party to elect between enforcing his security against the goods sold by repossession and resale, or executing a judgment for the price against the debtor's other assets.

The requirement that the secured party elect between his remedy against the goods and his action for the price does not apply where, after seizure, "the goods are destroyed or damaged to such an extent that the seller's security is materially impaired either by the wilful act of the buyer or by his neglect or otherwise."[9] This provision applies where, for example, the goods are released into the hands of the debtor after they have been repossessed. It is by no means clear why the secured party's remedies should continue to be restricted where the goods are destroyed or damaged to the extent that the security is materially impaired by some wilful or reckless act done by the debtor *before* seizure. It is worth noting in this context that the Newfoundland *Conditional Sales Act* relives the secured party from the obligation to

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4. *Conditional Sales Act*, R.S.A. 1970, c. 61, s. 19.

5. *Consumer Protection Act*, R.S.M. 1970, c. C200, s. 53.

6. *Conditional Sales Act*, S.N. 1955, c. 62, s. 12 as amended by S.N. 1962, c. 67.

7. R.S.A. 1970, c. 61, s. 19(2).

8. *Ibid.*, s. 19(3).

9. *Ibid.*, s. 19(6).

elect where the destruction or damage by the wilful act of the debtor or by his neglect or otherwise, takes place "before or after being repossessed by the seller."[10]

The meaning of the phrase "or otherwise" at the end of the subsection is unclear. It would seem that "wilful act ... or ... neglect" covers all the possible kinds of action that might be taken by the buyer. If so, it is difficult to read the phrase "or otherwise *ejusdem generis* with the preceding words and, the section may have the effect of serving the full range of common law remedies, including the deficiency claim, even in cases where after seizure the goods have been damaged or destroyed by some cause totally independent of the debtor. The reasonableness of this is not evident.

In a number of responses to the working paper it was urged on the Commission that adoption of the election principle would cause a significant decline in the volume and availability of consumer credit. This does not appear to have been the case in provinces which have adopted the election principle. It has been suggested to us that there are two reasons for this:

1. By far the majority of business is done by Canadian sales finance companies on a "recourse" or "repurchase" agreement basis with dealers, with the result that the dealer not the sales finance company, bears the brunt of any reduction in creditor remedies.

2. Election of remedies laws have not been operative in commercially important provinces to date and the consequences of the limitations have therefore been judged to be of less importance to the national sales finance company than the advantages of uniform administration across their branches.[11]

A decline in the volume of consumer credit should manifest itself notwithstanding the widespread existence of recourse agreements, since any loss due to a reduction in creditors' remedies would fall directly on the original credit grantor whose policies will determine the volume of credit. Since the dealers who would bear the loss tend to be locally based, the question of "uniform administration" should not arise. The Commission therefore feels that the experience of other provinces is indicative of the likely consequences should the election principle be adopted in British Columbia and that the volume of desirable consumer credit would not significantly decline.

For reasons set out at length in the working paper, the Commission has concluded that the less restrictive approach which has been adopted in Alberta is preferable. If the secured party elects to repossess, the debtor, unless it is possible that the sale might realize a surplus, has no interest in the party to whom the goods are sold or the price obtained. The sweetheart deal would no longer be a potential abuse. The Commission feels that another aim would be attained in that the requirement of an election of remedies might well make it more difficult for the irresponsible credit grantor to stay in business. In this connection Professor Ziegel has remarked:[12]

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10. *Conditional Sales Act*, S.N. 1955, c. 62, s. 12(7).

11. Contained in a submission to the Commission by the Federated Council of Sales Finance Companies, July 12, 1971.

12. Ziegel, *Consumer Credit Regulation: A Canadian Consumer-Oriented Viewpoint*, (1968) 68 Columb. L. Rev. 506.

> If a credit grantor acts responsibly the number of his repossessions will be small, his losses insignificant. If his repossessions have been high [the election] will have the designed effect - it will make him that much more careful unless he prefers, and is able, to pass on his losses in the form of higher credit charges. The general possibility of slightly higher charges should be no more alarming in this context than it is in the case of the manufacturer who is held strictly liable for defects in the goods manufactured by him.

The Commission recommends:

Legislation comparable to section 19 of the Alberta Conditional Sales Act *should be adopted in British Columbia with the exception of subsections (6) and (8) thereof and subject to modifications contained in the following recommendations.*

Exemption of Commercial Transactions

Subsection (8) of section 19 of the Alberta *Conditional Sales Act* which was omitted from the recommendation exempts from the operation of the section a sale of goods of a capital nature relating to the petroleum and natural gas industry and railways. The working paper proposed that that exemption be extended to include machinery and equipment used in mining and forestry. In response to the working paper the Commission received a number of cogent submissions suggesting that all "business purchases" should be exempted. The Commission has been persuaded by the arguments made in those submissions and has concluded that the election principle should be restricted to consumer purchases.

To distinguish between consumer purchases and business purchases, the Commission feels that the appropriate basis for a definition of "consumer purchase" is contained in the meaning given to the term "retail sale" as defined in section 21A(l) of the *Sale of Goods Act*.[13]

> For the purpose of this section "retail sale" includes every contract of sale made by a seller in the ordinary course of his business but does not include a sale of goods
>
> (a) to a purchaser for resale; or
>
> (b) to a purchaser who intends to use the goods in his business; or
>
> (c) to a corporation or an industrial or commercial enterprise; or
>
> (d) by a trustee in bankruptcy, a liquidator, or sheriff.

That definition, however, might exclude sales of goods which are purchased primarily for personal use but are occasionally used in the buyer's business. The Commission would, therefore, alter that definition by inserting the word "primarily" in section 21A(l) (*b*) after the word "goods."

The Commission recommends:

The proposed legislation restrict the operation of the election principle to goods sold by retail sale.

The term "retail sale" be defined as follows:

> *"retail sale" includes every contract of sale made by a seller in the ordinary course of his business but does not include a sale of goods*

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13. R.S.B.C. 1960, c. 344.

(a) to a purchaser for resale; or

(b) to a purchaser who intends to use the goods primarily in his business; or

(c) to a corporation or an industrial or commercial enterprise; or

(d) by a trustee in bankruptcy, a liquidator, or sheriff.

Application to Other Secured Parties

The Alberta legislation applies only to cases where the seller of goods retains a security interest in the goods sold to secure payment of the balance of the purchase price. It does not apply to cases where purchase money is advanced to the buyer by a third party who then takes a security interest in the goods nor does it apply to a security interest in goods taken to secure the performance of an obligation unrelated to the purchase of the goods. The exemption of the latter case from the election principle can be justified, however it is philosophically difficult to justify exemption of the former. The Commission has concluded that the election principle should apply in that case.

The Commission recommends:

The proposed legislation define "seller" so as to include a person who advances funds to a buyer for the purpose of enabling the buyer to acquire rights in goods with repayment secured by a security interest of that person in those goods.

Prohibition Against Collateral Security

An interest in the goods sold is not necessarily the only security that may be taken. The secured party may wish to obtain a security interest in other assets or he may wish to obtain the right to enforce the personal covenant to pay against persons other than the debtor.

The working paper considered the remedies available to the secured party who obtained a security interest not only in the goods sold but in other assets of the debtor as well.[14] It was pointed out that the wording of section 19 of the *Alberta Conditional Sales Act* would permit the secured party to either:

(a) repossess the other assets (but not the goods sold) and take a judgment for the deficiency or

(b) repossess both the other assets and the goods sold or

(c) obtain a judgment for the balance of the contract price.

In the working paper the Commission indicated that it felt that state of affairs would be acceptable, however it has reconsidered its position in that regard and concluded that permitting a seller to obtain a security interest in goods other than those sold tends to encourage the irresponsible granting of credit which the election principle was designed to curb. The Commission has, therefore, concluded that the seller of goods under a time sale agreement should not be permitted to obtain a security interest in goods other than those which are the subject of the sale.

Legislation prohibiting additional collateral has been enacted in Ontario and

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14. Working paper, para. 72.

Manitoba.[15] Section 56(1) of the Manitoba *Consumer Protection Act* provides:

> No part of the price of any goods comprised in a time sale that is not made on variable credit, or of the cost of borrowing thereof, may be secured on any goods not comprised in that time sale; and any provision or arrangement that purports to do so is void.

Position of Guarantors

The proposed legislation should make it clear that the benefit of the election is conferred not only upon the purchaser of the goods but also upon the guarantor of his obligations. To permit the seller to repossess the goods and claim any deficiency remaining after resale from a guarantor is quite inconsistent with the principle of the recommendations made. The law relating to guarantee may prohibit such a claim in any event; however the Commission feels that any legislation should make this perfectly clear. The Alberta legislation would appear to permit the seller to commence an action against a guarantor only, take judgment and collect what money he could, and still repossess the goods at a later date. This possibility should be eliminated. A provision to the effect that for the purposes of the limitation imposed on the secured party's rights, an action against a guarantor be deemed an action against the principal debtor should be effective.

Cases may arise where the guarantor is called upon to satisfy the balance owing under the contract. Both at common law and by the *Laws Declaratory Act*[16] he is entitled to an assignment of the secured party's rights against the principal debtor. In these circumstances, different considerations apply and the Commission feels it is inappropriate to require the guarantor to elect his remedies against the principal debtor. The guarantor should be permitted to repossess and claim the deficiency. While such a rule might leave the door open to fraudulent guarantees and consequent abuse, the Commission feels that in practice this will rarely arise and the balance of utility and justice lies with giving relief to the guarantor in such circumstances.

The relief given to guarantors should also be extended to indemnitors.

The Commission recommends:

The proposed legislation contain a provision comparable to section 56(1) of the Manitoba Consumer Protection Act, *prohibiting the taking of a security interest in goods other than those sold.*

The proposed legislation provide that an action against a guarantor be deemed to be an action against the principal debtor in cases where the secured party takes proceedings against a guarantor after repossession or attempts to repossess after taking proceedings against a guarantor.

The proposed legislation requiring a secured party to elect his remedy shall not apply to a guarantor or indemnitor who is subrogated to the rights of the secured party.

The proposed legislation define guarantor so as to include an indemnitor.

Exemption Where Security Impaired by Debtor

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15. R.S.O. 1970, c. 82, s. 34; R.S.F.M. 1970, c C200, s. 56(1).

16. R.S.B.C. 1960, c. 213, s. 2(23).

The Commission foresees that circumstances may arise where it would be inequitable to compel the secured party to elect his remedies and that in certain circumstances a seller should be permitted to claim a deficiency.

The Commission recommends:

The proposed legislation permit a secured party to enter judgment for a deficiency where the goods have been damaged to an extent that the security is materially impaired by:

(a) the wilful act of the debtor or,

(b) the reckless act of the debtor or,

(c) the negligent act of the debtor where the security agreement provided that the debtor carry appropriate insurance against the risk of such negligence and he has failed to do so

upon application by the secured party before or not later than 20 days after repossession to a court of competent jurisdiction.

Redemption and Contracts Relief

It has been pointed out that section 14(1) of the *Conditional Sales Act* provides that after repossession the seller must retain the goods for 20 days and during that period the buyer has the opportunity to redeem the goods. Where goods are repossessed, pursuant to a chattel mortgage, the right to redeem of the mortgagor continues in existence up to the time of sale. There is, however, no minimum length of time which the mortgagee is required to retain them before resale. Thus it is open to the mortgagee to repossess the goods and resell them within the hour. In those circumstances, any right of redemption is meaningless. The Commission therefore feels that where the security agreement takes the form of a chattel mortgage, the debtor should be given an opportunity to redeem analogous to that of the buyer under conditional sale agreement.

Nothing in the law requires that after repossession a chattel mortgagee give notice to the mortgagor of his right to redeem. The buyer under a conditional sale agreement is entitled to such notice only if the seller intends to look to him for a deficiency. If the recommendations contained in this Report are adopted, that notice requirement will be meaningless.

The Commission feels that a notice advising the defaulting debtor of his right to redeem should be mandatory in all cases involving a security interest in consumer goods. Such a notice could also contain a provision drawing the debtor's attention to that section of the *Consumer Protection Act* which provides relief against a buyer in default.

The Commission recommends:

Section 14 of the Conditional Sales Act *be amended*

(1) to extend its operation to repossession pursuant to a chattel mortgage; but not so as to extinguish the equitable right to redeem after 20 days;

(2) by deleting the words "if the price of the goods exceeds $30 and the seller intends to look to the buyer for any deficiency on a resale;"

(3) by deleting subsection 4 and providing that the form of the notice be prescribed by regulation.

The form of the notice so prescribed contain that information now required by subsection 4 and a provision drawing the buyer's attention to the contents of section 18 of the Consumer Protection Act.

Notice Before Repossession

It was suggested to the Commission in response to the working paper that there should be some provision requiring a secured party to serve notice on the debtor before repossession. Some of the advantages of this are obvious. It would give the debtor who would ordinarily redeem a chance to do so before the costs of repossession were incurred. If the notice set out the payment required to satisfy the account, it would also tend to catch mistakes. Circumstances may arise in which the debtor honestly believes he made a payment which he had in fact missed or conversely the secured party may have failed to credit the debtor with a payment which had in fact been made. Such mistakes can, and in fact do, occur even though both parties may be acting with the utmost good faith. It was suggested that the best time to catch mistakes is before, not after, repossession has occurred.

The one obvious disadvantage to a requirement of notice before repossession is that the fraudulent debtor, upon receiving such notice, may attempt to conceal the goods or take other steps to prevent repossession.

The Commission has thoroughly considered the effect of such a requirement and concludes that notice before repossession should not be required. The cases of *bona fide* mistakes will be few in number and as a matter of practice most secured parties will make a demand for payment before repossession in any event. If the recommendation that the debtor be given notice, after repossession, of his right to redeem is implemented the Commission feels that the utility of a notice before repossession is minimal. Accordingly, the Commission makes no recommendation that such notice be required.

Order Required Before Repossession in Certain Circumstances

If implemented, the recommendations thus far made would have the effect of forcing the secured party, if he repossesses, to resell for the best price obtainable unless the debtor's default occurs relatively late in the term of the contract. In that case, repossession and resale may cause the debtor unwarranted hardship. The Commission feels that where the debtor has a substantial equity in the goods and the resale might reasonably be expected to generate a surplus, the repossession procedure should be subject to special rules.

A number of jurisdictions have recently sought to deal with this problem. Section 35 of *The Consumer Protection Act, 1966*[17] of Ontario, for example, provides that:

> (1) Where a buyer under an executory contract has paid two-thirds or more of the purchase price of goods as fixed by the contract, any provisions in the contract, or in any security agreement incidental thereto, under which the seller may retake possession of or resell the goods upon default in payment by the buyer is not enforceable except by leave of a judge ...
>
> (2) Upon an application for leave under subsection (1), the judge may, in his absolute discretion, grant or refuse leave or grant leave upon such terms and conditions as he deems advisable.

17. S.O. 1966, c. 23, now R.S.O. 1970, c. 82.

In Manitoba, section 49(1) of the *Consumer Protection Act*[18] provides that:

> Where a seller on a time sale would be, but for this section, entitled to repossess any goods, and the balance owing by the buyer on those goods at that time is less than twenty-five per cent of the cash price of the goods at the time of the sale thereof, the seller may not repossess the goods without either the leave of the court or the written consent of the buyer given at the time of repossession.

A "time sale" is defined by section 1(AA) of that Act to include both retail conditional sales and retail sales of goods subject to a chattel mortgage. Section 49(4) provides that:

> In deciding whether to grant leave to repossess, or to set aside an order made ex parte, the court shall consider all relevant circumstances, including
>
> (a) the present value of the goods;
>
> (b) the amount already paid by the buyer;
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> (c) the balance owing by the buyer;
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> (d) the reasons for the buyer's default; and
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> (e) the present and likely future financial circumstances of the buyer and of the seller;
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> and the court may permit the buyer to keep the goods, or if they have been repossessed pursuant to an order made ex parte, to redeem them on such terms as it sees fit and may extend the time for payment by the buyer of the balance owing; but if it grants an extension, the court shall require the buyer to pay such additional amount as may be necessary to compensate the seller for the extension.

Section 57 of the Act includes comparable provisions governing the repossession rights of a chattel mortgage in respect of chattel mortgages not subject to section 49.

In Alberta, under the provisions of sections 25-29 of the *Seizures Act*,[19] a buyer may object to any repossession within 14 days of receipt of a "Notice of Seizure of Goods", and, if he does object, the seller may not proceed with a seizure except on the authority of a court order. In Saskatchewan, the *Limitation of Civil Rights Act*,[20] imposes similar restrictions upon the repossession rights of vendors of certain items considered important to agriculture in that province.

All of these provisions require a Court Order as a condition precedent to repossession in certain circumstances. These circumstances vary. In Ontario and Manitoba, the condition is that a specified proportion of the purchase price has been paid - in the former case two-thirds, in the latter, three-quarters. In Alberta, the condition is that the debtor objects to the repossession and in Saskatchewan, that the goods are of a certain kind and the debtor objects.

The Commission has concluded that the basic policy underlying provisions of

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18. R.S.M. 1970, c. C200. 63

19. R.S.A. 1970, c. 338.

20. R.S.S. 1965, c. 103.

this type is sound and that the right of a secured party to repossess should be exercisable only upon court order in cases where two-thirds or more of the purchase price has been paid. The Commission also feels that the court to whom application is made should be empowered, if an order for sale is made, to direct the mode of sale to ensure that a realistic price is obtained. The Commission also feels that the court should be provided with appropriate criteria to guide the exercise of its discretion.

The Commission recommends:

Without limiting the effect of earlier recommendations, the proposed legislation provide that where a debtor under a security agreement has paid two-thirds or more of the purchase price of the goods as fixed by the agreement:

(a) The secured party may not repossess the goods upon the default of the debtor except by order of the court which shall have absolute discretion to grant or refuse leave or grant leave upon such terms and conditions as is deemed advisable upon an application for leave to repossess;

(b) The court be guided by criteria analogous to those contained in section 49(4) of the Manitoba Consumer Protection Act*;*

(c) The court be empowered to direct the mode of sale if leave to repossess is granted;

(d) The "court" be that court which would otherwise have jurisdiction to enter judgment against the debtor for the balance of the contract price due.

Debtor Entitled to Surplus

One of the purposes of the foregoing recommendation was to ensure that any surplus generated by resale at that stage would tend to be maximized. The Commission feels that the debtor's right to that surplus should be put beyond all doubt. It has already been pointed out that a chattel mortgagor is entitled to such a surplus but the right of a conditional buyer is less clear. While the buyer may be so entitled where the contract contains a deficiency clause, as the *Chan* case, it has been noted that the case may be regarded as something of an anomaly so far as the law of sales is concerned. It is also possible that if the recommendations contained in this Report are enacted, some conditional sellers are likely to adopt a practice of eliminating deficiency clauses from their agreements and so make the *Chan* case inapplicable.

Newfoundland has enacted specific legislation in this regard. Section 12(9) of the Newfoundland *Conditional Sales Act*[21] provides that where a conditional seller repossesses and sells the goods:

> ... he shall pay over to the buyer the surplus, if any, remaining after the unpaid purchase price of the goods and the costs, if any, of the retaking and keeping possession and sale have been satisfied.

The Commission has concluded that such legislation would be appropriate in British Columbia.

The Commission recommends:

The proposed legislation contain a provision comparable to section 12(9) of the Newfoundland Conditional

21. S.N. 1955, c. 62, as amended by S.N. 1962, c. 67.

Sales Act *declaring the right of a conditional buyer to any surplus resulting from a resale.*

CHAPTER VII SUMMARY OF RECOMMENDATIONS

The Commission's recommendations in this Report may be summarized as follows:

1. Legislation comparable to section 19 of the Alberta *Conditional Sales Act* should be adopted in British Columbia with the exception of subsections (6) and (8) thereof and subject to modifications contained in the following recommendations.

2. The proposed legislation restrict the operation of the election principle to goods sold by retail sale.

3. The term "retail sale" be defined as follows:

   "retail sale" includes every contract of sale made by a seller in the ordinary course of his business but does not include a sale of goods

   (a) to a purchaser for resale; or

   (b) to a purchaser who intends to use the goods primarily in his business; or

   (c) to a corporation or an industrial or commercial enterprise; or

   (d) by a trustee in bankruptcy, a liquidator, or sheriff.

4. The proposed legislation define "seller" so as to include a person who advances funds to a buyer for the purpose of enabling the buyer to acquire rights in goods with repayment secured by a security interest of that person in those goods.

5. The proposed legislation contain a provision comparable to section 56(1) of the Manitoba *Consumer Protection Act*, prohibiting the taking of a security interest in goods other than those sold.

6. The proposed legislation provide that an action against a guarantor be deemed to be an action against the principal debtor in cases where the secured party takes proceedings against a guarantor after repossession or attempts to repossess after taking proceedings against a guarantor.

7. The proposed legislation requiring a secured party to elect his remedy shall not apply to a guarantor or indemnitor who is subrogated to the rights of the secured party.

8. The proposed legislation define guarantor so as to include an indemnitor.

9. The proposed legislation permit a secured party to enter judgment for a deficiency where the goods have been damaged to an extent that the security is materially impaired by:

   (a) the wilful act of the debtor or,

(b) the reckless act of the debtor or,

(c) the negligent act of the debtor where the security agreement provided that the debtor carry appropriate insurance against the risk of such negligence and he has failed to do so

upon application by the secured party before or not later than 20 days after repossession to a court of competent jurisdiction.

10. Section 14 of the *Conditional Sales Act* be amended

(a) to extend its operation to repossession pursuant to a chattel mortgage; but not so as to extinguish the equitable right to redeem after 20 days;

(b) by deleting the words "if the price of the goods exceeds $30 and the seller intends to look to the buyer for any deficiency on a resale;"

(c) by deleting subsection 4 and providing that the form of the notice be prescribed by regulation.

11. The form of the notice so prescribed contain that information now required by subsection 4 and a provision drawing the buyer's attention to the contents of section 18 of the *Consumer Protection Act*.

12. Without limiting the effect of earlier recommendations, the proposed legislation provide that where a debtor under a security agreement has paid two-thirds or more of the purchase price of the goods as fixed by the agreement:

(a) The secured party may not repossess the goods upon the default of the debtor except by order of the court which shall have absolute discretion to grant or refuse leave or grant leave upon such terms and conditions as is deemed advisable upon an application for leave to repossess;

(b) The court be guided by criteria analogous to those contained in section 49(4) of the Manitoba *Consumer Protection Act*;

(c) The court be empowered to direct the mode of sale if leave to repossess is granted;

(d) The "court" be that court which would otherwise have jurisdiction to enter judgment against the debtor for the balance of the contract price due.

13. The proposed legislation contain a provision comparable to section 12(9) of the Newfoundland *Conditional Sales Act* declaring the right of a conditional buyer to any surplus resulting from a resale.

E. D. FULTON
Chairman

R. GOSSE

Commissioner

R. C. BRAY

Commissioner

June 22, 1972.