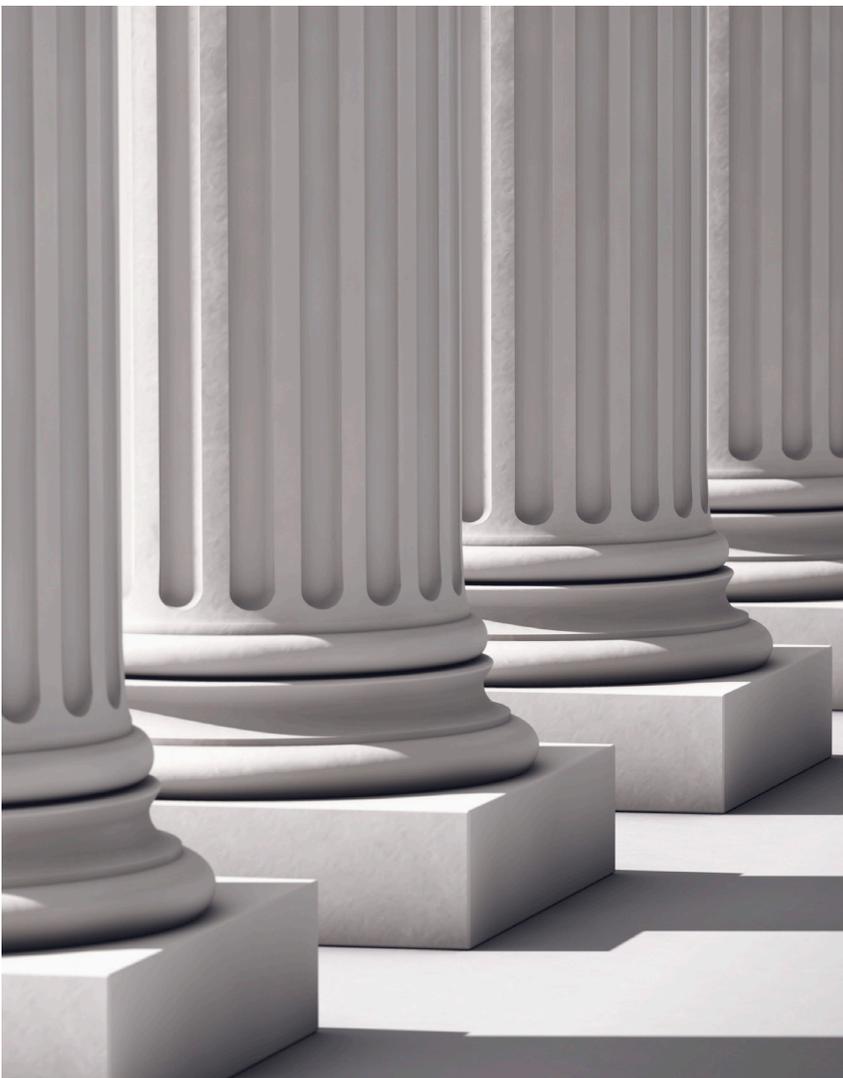




ALBERTA  
LAW REFORM  
INSTITUTE



# PERSONAL PROPERTY SECURITY LAW



REPORT FOR DISCUSSION

# 35

DEC 2020







## **PERSONAL PROPERTY SECURITY LAW**

REPORT FOR  
DISCUSSION || **35**

**DECEMBER 2020**

ISSN 0834-9037

ISBN 978-1-896078-82-3

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# Invitation to Comment

**Deadline for comments on the issues raised in  
this document is June 1, 2021**

This Report for Discussion by the Alberta Law Reform Institute [ALRI] makes recommendations to update the *Personal Property Security Act* in keeping with recommendations made by the Canadian Conference on Personal Property Security Law.

Issuing a Report for Discussion allows you the opportunity to consider these proposals and to share your views with us. You may respond to one, a few or all of the issues raised. Any comments sent to us will be considered when we make final recommendations.

You can reach us with your comments or with questions about this document on our website, or by mail or e-mail to:

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**Law reform is a public process. We assume that comments on this Report for Discussion are not confidential.** We may quote or refer to your comments. We usually discuss comments generally and without attribution. If you do not want your comments attributed to you, you may request confidentiality in your response or submit comments anonymously.



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# Alberta Law Reform Institute

The Alberta Law Reform Institute [ALRI] was established on November 15, 1967 by the Government of Alberta, the University of Alberta and the Law Society of Alberta for the purposes, among others, of conducting legal research and recommending reforms in the law. Funding for ALRI's operations is provided by the Government of Alberta, the University of Alberta and the Alberta Law Foundation.

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# Acknowledgments

This Report for Discussion relies heavily on the work undertaken by the Canadian Conference on Personal Property Security Law [CCPPSL], and in particular, the efforts of the members of the working group that developed the Proposals for Changes to the Personal Property Security Acts Report over a three year period beginning in 2014 and culminating in the adoption of the Report by the CCPPSL in June of 2017.

This Report for Discussion was written by Professors Tamara Buckwold and Roderick Wood, both of whom are acknowledged experts in secured transactions law with extensive experience in commercial law reform. Both also contributed as members of the CCPPSL working group. ALRI greatly appreciates the expertise and time they have contributed to this project.

ALRI partnered with the University of Alberta Faculty of Law in the creation of a Law Reform Internship that permitted upper year law students to learn about and participate in the law reform process. Aaron Aitken, Stephanie Barron, Aaron Johnson, Cohen Mill, Nader Parhamnia, Victoria Rudolf, Andrew Skeith, Isis Tse, and Camilla Zhang participated in this internship during the 2018–19 academic year, and prepared research papers on several key areas of *Personal Property Security Act* law reform. The internship was facilitated by Professors Buckwold and Wood and Sandra Petersson, ALRI Executive Director.

Briggs Larghuino, ALRI research student checked the references. Jenny Koziar prepared the report for publication.



# Summary

In this Report for Discussion, ALRI recommends that Alberta amend the *Personal Property Security Act* through the implementation of recommendations proposed by the Canadian Conference on Personal Property Security Law [CCPPSL] in its 2017 Report.

## **Why is Change Needed?**

Every Canadian province and territory, except for Quebec, has enacted a Personal Property Security Act [PPSA]. Although there are minor variations across jurisdictions, these statutes are substantially uniform. Alberta's current *Personal Property Security Act* came into force on October 1, 1990. The enactment of the PPSA transformed secured transactions law in Alberta by sweeping away many of the restrictions and limitations that impeded the use of secured credit. It replaced the piecemeal approach that formerly governed with a comprehensive and rational system that fostered certainty, transparency and flexibility. The success of the legislation is confirmed by the transplantation of the Canadian model into other jurisdictions such as New Zealand and Australia.

Although the PPSA produced a significant improvement in the law, experience with the legislation over the course of the last three decades has revealed several instances where improvements or clarifications are desirable. In some cases, the need for reform is driven by technological advances. When the PPSA was first enacted, electronic banking and electronic commerce were in their infancy. The CCPPSL recommendations facilitate the move to paperless transactions. In some cases, judicial decisions have revealed ambiguities in the legislation that have produced uncertainty. The recommendations would correct these deficiencies. In other cases, the statute simply did not anticipate the kinds of controversies that would be litigated in the future, and therefore did not provide rules for the resolution of these types of disputes.

## **The CCPPSL Report**

The CCPPSL is an organization of provincial and territorial government officials and academics. It has played a leading role in the design of the PPSA model that is used in Alberta. The CCPPSL Report of June 2017 made proposals for changes to the PPSA. These recommendations were fully implemented in Saskatchewan, which proclaimed the amendments into force on June 22, 2020. The proposals have been partially implemented in British Columbia and Ontario. We expect that other provinces will be similarly guided by the CCPPSL Report, and we propose that Alberta update its PPSA through the implementation of the CCPPSL recommendations.

The major areas of reform are summarized below:

- The choice of law rules are revised, and the method for determining the location of the debtor is changed so as to align with the new approach adopted in British Columbia, Saskatchewan and Ontario. This produces greater certainty in the law and avoids the deleterious effects of forum shopping that will inevitably arise if provinces and territories employ different choice of law rules.
- The rules that govern purchase-money security interests are clarified and expanded to provide greater guidance on this crucial form of financing. The changes enhance the ability of secured parties to claim purchase-money security interests in inventory, and preserve purchase-money security interest status in a refinancing.
- The rules governing the transfer of collateral to buyers and others are rationalized and improved.
- A number of uncertainties in the rules that determine priorities between secured parties and other competing claimants are clarified so as to produce greater certainty and predictability.
- The registration provisions are improved to better achieve the underlying goals of the registry system, namely the publication of information in a manner that will allow effective risk-assessment by affected parties.
- The concept of electronic chattel paper is introduced to facilitate paperless transactions where this form of property is sold or used as collateral.
- Secured financing is facilitated through amendments that clarify that valuable assets such as licences may be used as collateral, that eliminate red tape requirements that unnecessarily increase the administrative costs of secured finance, and that improve the ability of secured parties to take steps to protect their interest.

### **Changes to the *Civil Enforcement Act***

Although the recommendations in this Report for Discussion track the changes proposed in the CCPPSL Report, there is one additional area that requires reform in Alberta that is not covered in the CCPPSL Report. Changes to some of the PPSA priority rules make it necessary to adjust the analogous priority rules contained in the *Civil Enforcement Act* [CEA]. This presents a welcome opportunity to fix a number of problems associated with the current CEA priority rules so as to better harmonize the two sets of rules. The objective is to give a writ registered in the Personal Property Registry the same general priority status as a security interest perfected by registration.

# Recommendations

## RECOMMENDATION 1

The Alberta *Personal Property Security Act* [PPSA] should be amended to implement the reforms proposed in the Report of the Canadian Conference on Personal Property Security Law, and to provide a proper interface between the priority rules of the PPSA and the *Civil Enforcement Act*. .....4

## RECOMMENDATION 2

The choice of law rules identifying the law that governs “the effect of perfection or non-perfection” of a security interest should make it clear the law identified also governs the priority of the security interest.....8

## RECOMMENDATION 3

The location of a debtor should be determined as follows:

- (1) a registered organization, such as a corporation, partnership or trust, should be located in the jurisdiction in which the legally required public record of their organization, continuation or amalgamation is registered or, if created by legislation, in the legislating jurisdiction,
- (2) an individual, including a business debtor, should be located at their principal residence, and
- (3) a business entity that does not fall within either (1) or (2) should be located at its place of business or, if it has more than one place of business, in the jurisdiction of its chief executive office..... 18

## RECOMMENDATION 4

The choice of law rules that determine the validity, perfection and priority of a security interest when the debtor or the collateral moves from one jurisdiction to another should implement the following:

- (1) Perfection and priority should be governed by the law of the jurisdiction in which the collateral or the debtor, respectively, are presently located;
- (2) The rule that governs continued perfection when the debtor relocates should apply only when the debtor moves into Alberta and should not apply to the transfer of an interest in collateral;
- (3) A security interest in goods that are expected to and do move into a jurisdiction other than that in which they are originally located within 30 days of the date of attachment should be valid and perfected if valid and perfected under the law of either the original or the new jurisdiction..... 24

## RECOMMENDATION 5

The law governing the priority of a security interest in tangible chattel paper, negotiable documents of title, instruments and money should be the law of the jurisdiction where the collateral is located, regardless of whether the security interest is possessory or non-possessory..... 25

## RECOMMENDATION 6

The choice of law rules should eliminate renvoi and should apply in the same manner whether or not there is a public registry in the jurisdiction in which the debtor is located. .... 27

**RECOMMENDATION 7**

A purchase-money security interest [PMSI] should not lose its status if the security agreement also secures an obligation that is not a purchase-money obligation, the agreement creates a security interest in other collateral to secure the purchase-money obligation, or the purchase-money obligation has been renewed, refinanced, consolidated, or restructured. .... 33

**RECOMMENDATION 8**

A secured party who has been given a PMSI in inventory should be able to claim PMSI status in all the inventory that it finances to secure all of the purchase-money obligations that are incurred. This feature should only be available if the parties agree to this on or before the initial transaction. .... 35

**RECOMMENDATION 9**

A secured party who pays out a PMSI held by a third party should be deemed to have taken an assignment of the PMSI and should be entitled to register a financing statement in respect of it. The PMSI will retain its priority over an earlier security interest if notice of the refinancing is given to the earlier secured party. .... 38

**RECOMMENDATION 10**

Where a debtor owes more than one obligation to a secured party and the manner in which payments are to be allocated has not been determined by the parties, payments made by the debtor should be applied first towards unsecured obligations in the order they were incurred, next towards non-PMSIs in the order they were incurred, and finally towards PMSIs in the order they were incurred. .... 40

**RECOMMENDATION 11**

The special priority rule that gives a prior accounts financier priority over an inventory financier who claims a proceeds PMSI in accounts should not apply to an account in the form of a deposit with a deposit taking institution. .... 41

**RECOMMENDATION 12**

The priority rules governing perfected and unperfected security interests in money, funds transferred electronically, instruments, negotiable documents of title and chattel paper should be consolidated in one section of the Act and rationalized to operate consistently across forms of collateral. .... 49

**RECOMMENDATION 13**

A deposit-taking institution that is a creditor of its depositor should defeat a security interest in the funds or the source of funds in the depositor's account only when allocation of funds in the account to payment of a debt owed to the institution is expressly authorized by the depositor in the manner specified. This rule should not preclude the exercise of rights of set-off otherwise recognized by the Act. .... 51

**RECOMMENDATION 14**

The requirement that a transferee, buyer or lessee be without knowledge of a security interest to claim priority should be eliminated in the priority

provisions respecting unperfected security interests, serial number goods held as equipment, and low value consumer goods. .... 54

**RECOMMENDATION 15**

The monetary limit that applies to the priority rule governing low-value sales and leases of consumer goods should be prescribed by regulation and should be increased from \$1,000 to \$1,500..... 55

**RECOMMENDATION 16**

A person should not be considered to be a buyer of goods under the buyer protection priority rules unless property in the goods has passed to the person. The retention or reservation of title in a contract of sale should be limited in effect to the reservation of a security interest and should not delay transfer of title to the buyer pursuant to the contract. .... 56

**RECOMMENDATION 17**

If a security interest has priority over the interest of a buyer or lessee, the priority should extend to all advances made by the secured party including advances made after the interest of the buyer or lessee arises. .... 58

**RECOMMENDATION 18**

The Act should provide that a security interest in collateral is not effective against the trustee in bankruptcy or a liquidator if the security interest is unperfected at the “time of the bankruptcy” or at the “time the winding-up order is made.” ..... 59

**RECOMMENDATION 19**

When a security interest is perfected by registration before a debtor becomes bankrupt but the registration lapses or is discharged, the lapse or discharge should not affect the priority of the security interest as against the trustee in bankruptcy if the security interest is re-registered not later than 30 days after the lapse or discharge, even though the re-registration occurs after the time of bankruptcy..... 61

**RECOMMENDATION 20**

The priority of a security interest in relation to another security interest in the same collateral should not be affected by enforcement measures taken by the holder of the other security interest..... 65

**RECOMMENDATION 21**

An account debtor should be permitted to assert any right of set-off in relation to the account against a party claiming a security interest in the account, except where a secured party who claims an interest in the account as proceeds has given a notice of their claim to the account debtor before the security interest attaches setting out information sufficient to enable the account debtor to reasonably ascertain the account transaction to which the claim relates. .... 71

**RECOMMENDATION 22**

The rules for registration of serial numbers should implement the following policies:

- (1) Serial number registration of serial number goods held as consumer goods should be optional rather than mandatory, and consumer goods

- should be afforded the same treatment as equipment in relation to priority competitions;
- (2) In a priority competition over serial number goods held as equipment or consumer goods, registration of serial numbers should be required to perfect a security interest, including a PMSI, as against a competing secured party;
  - (3) Registration of serial numbers must be effected by registration of the serial number in the field in the financing statement labelled for the receipt of serial numbers. .... 79

**RECOMMENDATION 23**

- The key principles of the test for seriously misleading errors should be codified in the PPSA, namely:
- (1) A registration should be invalid if a registry search using the correct debtor name does not disclose the registration;
  - (2) A registration should be invalid if a registry search using the correct serial number does not disclose the registration in those instances where serial number registration is required for priority;
  - (3) The fact that a registration is disclosed other than as an exact match does not by itself mean that a registration is valid. .... 83

**RECOMMENDATION 24**

The special rule that requires a debtor to seek a court order for the discharge or amendment of a registration if a trust indenture is involved should be eliminated. The usual rule that gives the debtor the right to discharge or amend a registration if a secured party fails to take steps to protect its registration within 40 days should apply instead..... 85

**RECOMMENDATION 25**

The concept of electronic chattel paper should be adopted. A security interest in electronic chattel paper should be enforceable against third parties if the secured party has control of it, and should be capable of being perfected by control. .... 92

**RECOMMENDATION 26**

- The priority rules respecting chattel paper should be revised by:
- (1) giving a purchaser of chattel paper priority if the chattel paper is not marked with a notation that it has been assigned to another, rather than making this priority depend on an absence of knowledge;
  - (2) adding perfection by control of electronic chattel paper to the residual priority rule that applies to competitions between secured parties; and
  - (3) giving a purchaser who takes possession of tangible chattel paper for value and in the ordinary course purchaser’s business priority over a person who obtains control of electronic chattel paper in cases where tangible chattel paper and electronic chattel paper co-exist. .... 94

**RECOMMENDATION 27**

The definition of “intangible” should include a licence. The definition of licence should extend to a licence that is transferrable subject to restriction, including a licence that is subject to cancellation and reissuance by the licensor at the request of the licensee or secured party. 100

**RECOMMENDATION 28**

The rules governing security interests in after-acquired property should not restrict attachment of an interest in after-acquired crops. .... 101

**RECOMMENDATION 29**

The Act should include a provision to make it clear that a subordination agreement does not in itself create a security interest. .... 102

**RECOMMENDATION 30**

An enforcing secured party should be required to give notice of an intended disposition of collateral to all persons who hold a security interest in the property to be disposed of, regardless of whether their interest has priority over or is subordinate to the interest of the enforcing party. .... 104

**RECOMMENDATION 31**

The PPSA and CEA priority rules should be harmonized by amending the CEA to provide that a writ registered in the Personal Property Registry is generally afforded the same priority status with respect to personal property as a security interest perfected by registration. .... 120



# Table of Abbreviations

## LEGISLATION

Alberta Act	<i>Personal Property Security Act</i> , RSA 2000, c P-7 Also referred to as PPSA
Article 9	See UCC
AUSPPSA	<i>Personal Property Securities Act 2009</i> (Cth), 2009/130
CEA	<i>Civil Enforcement Act</i> , RSA 2000, c C-15
PPSA	<i>Personal Property Security Act</i> , RSA 2000, c P-7 where context indicates Alberta alone. Where context indicates the legislation of Alberta as well as other provinces and territories, PPSA refers to statutes generally corresponding with the Alberta <i>Personal Property Security Act</i> and similarly titled.
Regulation	<i>Personal Property Security Regulation</i> , Alta Reg 95/2001
Saskatchewan amendments	<i>The Personal Property Security Act Amendment Act</i> , SS 2019, c 15
SPPSA	<i>The Personal Property Security Act, 1993</i> , SS 1993, c P-6.2 as amended by <i>The Personal Property Security Act Amendment Act</i> , SS 2019, c 15
STA	<i>Securities Transfer Act</i> , SA 2006, c S-4.5
UCC	Uniform Commercial Code § 9 (2010)

## ORGANIZATIONS AND PUBLICATIONS

CCPPSL	Canadian Conference on Personal Property Security Law
CCPPSL Report	Canadian Conference on Personal Property Security Law, <i>Proposals for Changes to the Personal Property Security Acts</i> , Canadian Conference on Personal Property Security Law, 2017 CanLIIDocs 3526, < <a href="http://www.canlii.org/t/sl12">http://www.canlii.org/t/sl12</a> > [ <a href="https://perma.cc/B3MG-ES4Z">https://perma.cc/B3MG-ES4Z</a> ]

**ILLUSTRATIVE HYPOTHETICALS**

D	Debtor
SP	Secured Party

**TECHNICAL TERMS**

PMSI	Purchase-Money Security Interest
------	----------------------------------

# Glossary

## **Account**

A right to payment of money. An account is a subcategory of intangible. The right to payment does not have to be a current debt and it does not have to be earned.

## **Assignment**

The transfer of property or an interest in property from one person to another. The term is primarily used in connection with a transfer of an intangible (such as an account).

## **Attachment**

The time when a security interest comes into existence. This occurs when value is given (usually the extension of credit or a binding promise to extend credit), the debtor has rights in the collateral and the security agreement is enforceable against third parties.

## **Chattel Paper**

One or more documents that evidence both a monetary obligation, together with a security interest in or lease of specific goods. Although the existing concept of chattel paper required the existence of physical document (tangible chattel paper), the CCPPSL recommendations would recognize electronic chattel paper if certain requirements are satisfied.

## **Collateral**

Personal property that is subject to a security interest.

## **Consumer Goods**

Goods that have been acquired by the debtor for personal, family or household purposes. Goods intended for resale or acquired for use in a business are not classified as consumer goods.

## **Document of Title**

Writings that are issued to a bailee of goods that identify the goods and state that the bailee is entitled to receive, hold, transfer and dispense of the goods covered in the writing. There are two forms of documents of title: bills of lading and warehouse receipts.

## **Equipment**

A residual definition that covers goods that are not classified as “consumer goods” or “inventory”.

**Future Advance**

Credit that is extended after a security agreement has been executed.

**Goods**

Tangible personal property (ie, those forms of personal property that have a physical existence, but not including chattel paper, documents of title, instruments, investment property or money that may be represented by a paper document).

**Instrument**

A writing that evidences a right to payment of money and is ordinarily transferred by delivery. The term includes a bill, promissory note or cheque within the meaning of the federal *Bills of Exchange Act*.

**Intangible**

Personal property that does not fall within any of the other categories of collateral (goods, chattel paper, documents of title, instruments, investment property and money). Intangibles have no physical existence and include accounts and intellectual property rights.

**Inventory**

Goods which are held by a business for sale or lease, or that have been leased by that person. The term also includes raw materials used in production, goods furnished under a service contract, and materials used or consumed in a business.

**Investment Property**

A security, such as a share or bond, a securities account with a broker, a futures contract or futures account.

**Money**

A medium of exchange authorized by the Parliament of Canada or authorized or adopted by a foreign government as part of its currency. It does not include bank accounts, bonds or promises to pay money.

**Perfection**

A protective step that is required in order to give a security interest priority over a trustee in bankruptcy of the debtor and other third parties. There are four methods of perfection: perfection by possession, perfection by registration, temporary perfection and perfection by control. A security interest that has not been perfected by one of those methods is said to be unperfected.

### **Personal Property**

Things subject to ownership that are not interests in land. The PPSA divides personal property into seven sub-categories goods, chattel paper, documents of title, goods, instruments, intangibles, investment property, and money.

### **Possessory Security Interest**

A security interest under which the secured party takes possession of the collateral during the course of the financing relationship. Intangibles cannot be the subject-matter of a non-possessory security interest because they do not have a physical existence.

### **Proceeds**

Identifiable or traceable personal property acquired by the debtor out of a dealing in the original collateral or its proceeds.

### **Purchase-Money Security Interest**

A security interest taken in a new asset that the debtor acquires by virtue of an extension of credit that enable the debtor to acquire the new asset. The term also encompasses certain deemed security interests.

### **Security Interest**

An interest in personal property that secures payment for performance of an obligation. Certain other transactions (such as a lease for a term of more than one year) are deemed to be security interests for the purposes of the PPSA.

### **Serial Number Goods**

A term defined in the Personal Property Regulations to mean a motor vehicle, trailer, mobile home, aircraft airframe, boat or an outboard motor for a boat. The mere fact that goods have a serial number is not sufficient to bring them within this definition.

### **Writ of Enforcement**

A document used to initiate the enforcement remedies available to an unsecured creditor who has obtained a judgment.



## CHAPTER 1

# Introduction

## A. Background

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[1] The Alberta *Personal Property Security Act* [PPSA] came into force in 1990.<sup>1</sup> The PPSA revolutionized secured transactions law. Pre-PPSA law was a patchwork in which common law and equitable principles were supplemented by a variety of statutes that governed different types of security transactions. The system had developed piecemeal such that the rules that governed one type of security device were different from the rules that governed another. The differences were based on form rather than function, and the system was not designed to produce outcomes that promoted business efficacy.

[2] Every province and territory in Canada other than Quebec has enacted a PPSA. The Ontario version of the PPSA was the first to be enacted in Canada, and it differs in several respects from the model that is used in the other common law jurisdictions. The original model for the Canadian Acts was taken from Article 9 of the Uniform Commercial Code of the United States, although several important changes were made in adapting the legislation. New Zealand and Australia have also enacted a PPSA based on the Canadian model.

## B. The Fundamental Objectives of Secured Transactions Law Reform

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[3] The PPSA swept away the former system and replaced it with a comprehensive statute that was designed to achieve the following fundamental objectives:

1. Facilitation: the reforms should promote the availability of secured credit in a simple and efficient manner.
2. Comprehensiveness: the reforms should not be limited to particular categories of assets, but should permit the use of all of the debtor's assets for credit support.

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<sup>1</sup> *Personal Property Security Act*, RSA 2000, c P-7 [PPSA].

3. Flexibility: the reforms should allow the parties to tailor the secured transaction to meet their specific needs.
4. Transparency: The reforms should enhance risk-assessment by publishing the potential existence of a security interest.
5. Certainty and predictability: The reforms should provide clear rules as to the ranking of competing claims.
6. Efficiency: The reforms should be designed so as to reduce the costs of taking and enforcing a security interest.
7. Uniformity: The reforms should be coordinated with those introduced in other provinces and territories so as to promote uniformity in the law.

### **C. The Need for Reform**

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[4] The PPSA has been widely recognized as a highly successful reform project. One measure of this success is the extent to which the Canadian model has been exported to other countries.<sup>2</sup> Nevertheless, over the course of thirty years there are several problems with the operation of the system that have become apparent. In some instances, the difficulty arises due to advances in technology. At the time the PPSA was enacted, electronic banking was in its infancy. As a result, the PPSA deals with payments through use of the cheque but not electronic payment systems. This leaves a gap in the legislation and has produced uncertainty in the law. The concept of chattel paper, discussed in depth in Chapter 7, is currently paper-based. A move to a concept of electronic chattel paper would yield major efficiencies as it would eliminate the need to transport and store paper in undertaking transactions with this form of property.

[5] In other instances, judicial decisions have identified ambiguities and weaknesses in the legislation. For example, the test for determining the invalidity of a registration due to an error in recording the required information lacks precision. Some courts have interpreted it to mean that a registration containing an error can be valid even though a search using the correct information does not reveal it. This undermines the value of transparency and also diminishes the goal of fostering predictability and certainty.

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<sup>2</sup> See R Wood, "Identifying borrowed sources in secured transactions law reform" (2019) 24:3 Unif L Rev 545.

[6] In June of 2017, the Canadian Conference on Personal Property Security Law [CCPPSL] ratified a Report on Proposals for Changes to the Personal Property Security Acts [CCPPSL Report].<sup>3</sup> The CCPPSL is an organization of provincial and territorial government officials and academics. It has played a leading role in the design of the PPSA model that is used in every Canadian common law jurisdiction with the exception of Ontario. Saskatchewan enacted legislation that implemented all of the proposals in 2019, and which came into force on June 22, 2020. British Columbia and Ontario have also recently enacted legislation that adopted some, but not all, of the proposals.

[7] This Report for Discussion recommends the adoption of the proposals for reform set out in the CCPPSL Report. Given that these recommendations were implemented in Saskatchewan, we have frequently reproduced the Saskatchewan provisions in this Report to illustrate the legislative drafting that would likely be employed in the adoption of these recommendations in Alberta.<sup>4</sup> We invite comment on the advisability of implementing the CCPPSL proposals for reform as well as any comments as to the specific legislative amendments employed in Saskatchewan to give effect to these recommendations. The Report also recommends amendment of provisions of the Alberta *Civil Enforcement Act* that affect the priority of security interests in personal property to ensure a proper interface between those provisions and the priority rules of the PPSA as amended.

[8] Some of the proposed amendments are highly technical in their design. Instead of presenting each element as a separate recommendation, we have described the details under the heading “Key Elements” so that the fundamental nature of the recommendation is not obscured. The Key Elements together with the reproduced provisions of the Saskatchewan amendments help the reader to understand how these detailed provisions fit together so as to achieve the general objective set out in the recommendation.

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<sup>3</sup> Canadian Conference of Personal Property Security Law, *Proposals for Changes to the Personal Property Security Acts*, Canadian Conference on Personal Property Security Law, 2017 CanLiiDocs 3526, online: <<http://canlii.org/t/s112>> [<https://perma.cc/B3MG-ES4Z>] [CCPPSL Report].

<sup>4</sup> *The Personal Property Security Act*, 1993, SS P-6.2 as amended by *The Personal Property Security Amendment Act*, 2019, c 15 [SPPSA].

**RECOMMENDATION 1**

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The Alberta *Personal Property Security Act* [PPSA] should be amended to implement the reforms proposed in the Report of the Canadian Conference on Personal Property Security Law, and to provide a proper interface between the priority rules of the PPSA and the *Civil Enforcement Act*.

## CHAPTER 2

# Choice of Law Rules

## A. Introduction

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[9] The PPSA includes choice of law rules that determine whether the law of Alberta or that of another jurisdiction governs the validity, perfected status, priority and enforcement of security interests in various types of collateral. Consistency in the choice of law rules of the Canadian PPSAs ensures predictability of outcomes and transactional efficiency in secured financing transactions. A simple scenario serves to illustrate the point:

D is a corporation incorporated in Ontario. However, D's chief executive office is located in Alberta. D has operating branches in Ontario, Alberta and Saskatchewan. D gives SP a security interest in the accounts generated by its Saskatchewan operations.

[10] The priority of SP's security interest in the accounts relative to competing claims will depend on whether it is perfected and the consequent operation of the applicable priority rules, which depend primarily on the perfected or unperfected status of the interest and the time of the perfecting step. Perfection is most often achieved by a valid registration in the appropriate registry. The appropriate registry is the registry operated under the law that governs security interests in intangibles. It is therefore necessary to determine whether the law governing perfection of SP's security interest in the accounts is the law of Ontario (where D was incorporated), Alberta (where D has its chief executive office) or Saskatchewan (where the accounts were generated).

[11] If the PPSAs of all Canadian jurisdictions point to the same registry, SP can easily ascertain where it should register to achieve perfection. Similarly, anyone dealing with D can identify the registry that should be searched to determine whether D's property is subject to a perfected security interest that might have priority over any interest they may acquire. Registering parties and searching parties can also determine with certainty whether the applicable priority rules are those of Alberta or some other province.

[12] Conversely, if different jurisdictions adopt different choice of law rules, confusion, error and uncertainty are likely to result. Secured parties may find that their security interests are unperfected because they registered in the wrong place, and searching parties may find their interest subordinated to perfected

security interests they did not discover because they searched the wrong registry. Further, the outcome of a priority dispute may differ depending on where the dispute is litigated. Assume that D in the scenario grants a security interest in accounts to another secured party and a priority dispute arises between the two secured parties. If the choice of law rules of all provinces are the same, the outcome of litigation will be the same regardless of where the dispute is litigated: the courts of any province will apply the same law. However, if the choice of law rules of Ontario are different from those of Alberta, the result of litigation in Ontario may be different from the result of litigation in Alberta. The Ontario court will apply the choice of law rules of the Ontario PPSA while the Alberta court will apply the rules of the Alberta Act. SP's security interest may be perfected if the dispute is litigated in Alberta but unperfected if litigated in Ontario, or vice versa.

[13] Until recently, the choice of law rules in all Canadian PPSAs were virtually the same. Registering parties and searching parties could easily determine the law that that governed the validity, perfection and priority of a security interest and could therefore readily ascertain where to register or search. In the event of a dispute, the outcome of litigation would be the same regardless of where within the common law jurisdictions the litigation took place.<sup>5</sup> However, that uniformity no longer exists, as some provinces have moved to adopt different rules. The most significant difference lies in the rules that determine the law governing security interests in intangible collateral and some types of mobile goods. In the above scenario, the Ontario PPSA now identifies the law of Ontario (the place of incorporation) as the governing law while the Alberta PPSA applies the law of Alberta (the location of the chief executive office). If SP registered in Alberta, its interest would be perfected for purposes of litigation in Alberta but not for purposes of litigation in Ontario.

[14] The choice of law rules governing intangibles are discussed more fully below. We flag the difference here to illustrate the importance of uniformity across the country. A primary goal of the CCPSL recommendations in this context is to prompt legislatures to amend their PPSAs to incorporate uniform choice of law rules. A second goal is to update the choice of law rules to better address some issues. In this report we recommend adoption of all of the CCPSL recommendations in aid of promoting both goals. Those changes have already been enacted in Saskatchewan. Legislative change in Alberta is likely to increase

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<sup>5</sup> Our discussion addresses only the choice of law rules of the provinces and territories that have enacted PPSAs, being all except Quebec.

the momentum for change across the country and thereby re-establish the uniformity that is so important in this area.

## **B. The Rules that Determine Priority**

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[15] The priority of a security interest depends on three central factors: (1) whether it is a valid interest, (2) whether it is perfected, and (3) the application of the relevant priority rules. The law governing these factors is identified under the rules in sections 5 through 7.1. The law governing enforcement of a security interest as between the parties to the security agreement is determined under section 8 according to different criteria. The recommendations in this report relate almost entirely to the rules that determine the priority of a security interest in collateral other than investment property; namely, the rules in sections 5 through 7. Sections 7.1 and 8.1 apply to security interests in investment property. These rules were added in 2006 with the adoption of other new provisions designed to interface the PPSA with the conceptual structure and system of regulation introduced by the *Securities Transfer Act*.<sup>6</sup> The choice of law rules for investment property are uniform across the country and only one substantive amendment is suggested.<sup>7</sup> The following discussion pertains to the rules in sections 5 through 7 except where section 7.1 is specifically mentioned.

[16] The choice of law rule that applies to a given security interest depends on the nature of the collateral. Section 5 applies to security interests in goods, other than those falling within section 7, and possessory security interests in chattel paper, a negotiable document of title, an instrument or money (“documentary collateral”). The law that governs validity, perfection and priority under section 5 is the law of the jurisdiction where the collateral is situated when the security interest attaches (the “location of the collateral rule”). Section 6 provides an ancillary rule for cases involving goods that the parties intend to move to a jurisdiction other than the one in which they were located when the security interest attached. Section 7 applies to security interests in intangibles, goods of a kind that are normally used in more than one jurisdiction and held by the debtor either as equipment or as lease inventory, and non-possessory security interests in documentary collateral. The law that governs validity, perfection and priority

<sup>6</sup> *Securities Transfer Act*, SA 2006, c S-4.5 [STA].

<sup>7</sup> PPSA, s 7.1(3)(a) states that the location of a debtor for purposes of s 7.1 is determined by s 7(1). The reference to s 7(1) will have to be changed to correspond with changes in the numbering of the provisions of s 7 dealing with location of the debtor if the recommendations to that effect are adopted. A minor substantive change is recommended with respect to s 7.1(6). See Heading E.2 below.

under section 7 is the law of the jurisdiction where the debtor is located (the “location of the debtor rule”).

## **C. The Effect of Perfection or Non-Perfection and Priority**

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[17] The rules in sections 5, 6 and 7 speak to the “validity, perfection and effect of perfection or non-perfection” of a security interest. These rules implicitly identify the law that determines the priority of a security interest, since priority is determined by “the effect of perfection or non-perfection”. The newer rules of section 7.1 address the issue of priority by referring to “the effect of perfection or non-perfection *and the priority*” of a security interest in investment property. The express reference to “priority” avoids potential confusion and should be included in the other choice of law rules.

### **RECOMMENDATION 2**

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The choice of law rules identifying the law that governs “the effect of perfection or non-perfection” of a security interest should make it clear the law identified also governs the priority of the security interest.

## **D. Location of the Debtor Rule**

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### **1. OVERVIEW**

[18] Subsection 7(2) of the Act sets out a “location of the debtor” rule which identifies the law that governs the validity, perfection and effect of perfection or non-perfection (ie priority) of a security interest in intangibles and highly mobile goods held as equipment or lease inventory. The location of the debtor as defined in section 7 also determines the law that applies to perfection of a security interest in investment property in the cases specified in subsection 7.1(5).

[19] Subsection 7(1) of the Alberta Act identifies the place where the debtor is located for purposes of these rules as follows:

- (a) at the debtor’s place of business, if the debtor has a place of business,
- (b) at the debtor’s chief executive office, if the debtor has more than one place of business, and

- (c) at the debtor's principal residence, if the debtor has no place of business.

[20] All of the PPSAs originally contained the same provisions. However, Ontario, British Columbia and Saskatchewan have recently adopted new and different rules defining the place where the debtor is located.<sup>8</sup> The changes are designed to identify the location of a business debtor with greater certainty.

[21] The primary concern to which these changes respond is the uncertainty and consequent transaction costs associated with the need to identify the "chief executive office" of a business debtor that has more than one place of business. Identification of a debtor's chief executive office cannot be determined by resort to a business registry or other stable criterion but rather is a fact-based and context specific exercise. There is no Canadian case law establishing the factors that identify the chief executive office. United States courts have followed the test set out in the Official Comment on the corresponding term as it appears in UCC Article 9, being "the place from which the debtor manages the main part of its business operations or other affairs. This is the place where persons dealing with the debtor would normally look for credit information."<sup>9</sup> The potential difficulty involved in locating the "main part" of a debtor's business operations or affairs led Ontario legislators to follow the lead of the Article 9 drafting committee who, in Revised Article 9, abandoned the chief executive office test with respect to perfection of security interests granted by US business entities in favour of set of rules based largely on the registries recording the jurisdiction in which such entities were organized.<sup>10</sup>

[22] Ontario legislation adopting the new rules was passed in 2006 but proclamation was delayed until 2015 in the hope that other jurisdictions would enact corresponding reforms. British Columbia and Saskatchewan did so.<sup>11</sup> The recommendations in the CCPPSL report parallel the main thrust of the Ontario rules, but depart from them on the points discussed below. Notably, Saskatchewan has now adopted legislation implementing the CCPPSL version of

<sup>8</sup> *Personal Property Security Act*, RSO 1990, c P.10, ss 7(3) and (4); *Personal Property Security Act*, RSBC 1996, c 359, ss 7(1) and (1.1); SPPSA s 7.

<sup>9</sup> See *Official Comment (2) Uniform Commercial Code § 9-307 (2010) [UCC]*; and see further CCPPSL Report heading II (12)(a)(i). The leading American case is *Mellon Bank, NA v Metro Communications Inc*, 945, F2d 635 (3rd Cir 1991).

<sup>10</sup> Article 9 retains the chief executive office rule to determine the location of foreign business entities, including Canadian entities.

<sup>11</sup> Bill 6, *Finance Statutes Amendment Act*, 2nd Sess, 39th Leg, British Columbia (Assented to 31 March 2010), SBC 2010 c 4, ss 43 – 47 (BC); Bill 102, *The Personal Property Security Amendment Act*, 2010, 3rd Sess, 26th Leg, Saskatchewan (Assented to 20 May 2010), SS 2010 c 26, ss 5, 6 (SK).

the rules in place of the legislation that previously followed Ontario. Readers are referred to the CCPPSL report for the detailed reasons explaining the differences between the Ontario rules and the proposed CCPPSL rules, now adopted in Saskatchewan.<sup>12</sup>

[23] The changes proposed incorporate three general strategies. Corporations and other registered organizations would be located in the jurisdiction in which they are registered rather than at their chief executive office. The distinction between individuals who carry on business and those who do not would be eliminated: all individual debtors would be located at their principal residence. The terms “place of business” and “chief executive office” would be retained but defined and applied only to business entities that do not fall within either of the two primary rules: such entities would be located at their place of business or, if they have more than one, at their chief executive office. Particular rules would be provided for the special case of trusts.

## 2. INDIVIDUAL DEBTORS

[24] The current rules provide that a debtor who is an individual is located at their place of business, or at their chief executive office if there is more than one place of business. If the debtor has no place of business, the debtor is located at their principal residence. Substitution of a “principal residence” rule for all individual debtors, regardless of whether or not they operate a business, allows the applicable law to be determined with greater certainty and at lower cost.

### *Key Element*

A debtor who is an individual should be located at their principal residence, whether or not they are a business debtor.

## 3. CANADIAN BUSINESS ENTITIES

[25] The Ontario and CCPPSL rules locate a Canadian business entity in the jurisdiction in which there is a publicly searchable record of their organization (ie creation), continuation or amalgamation. The most significant of these is the rule that provides in effect that an incorporated debtor is located in the province in which it is registered in the corporate registry or, in the case of a federally incorporated debtor, the jurisdiction of its registered head office. The rule applies to similar effect in relation to other entities legally organized by the filing of a record with or the issuance of a record by a provincial, territorial or federal

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<sup>12</sup> CCPPSL Report heading II (12).

government where the record is available to the public, or by the enactment of legislation. A rule based on the location of a designated record points to a clearly identifiable and stable jurisdiction and, in so doing, provides greater certainty in locating a business debtor than does the current “chief executive office rule”.

[26] The rule applies if (1) a debtor entity is an “organization” as defined, and (2) the entity is organized, continued or amalgamated by a mandatory registration in a public registry or by legislative enactment. “Organization” means a “business trust, estate, trust, partnership, limited liability corporation, association, joint venture, government, governmental subdivision, agency or instrumentality, public corporation or any other legal or commercial entity”.

[27] A Canadian business entity that is not an “organization”, or an organization that is not registered in the relevant sense, is subject to a residual rule that captures any case that does not fall within a more specific rule. The residual rule provides that a business debtor that has only one place of business is located at that place of business, while a debtor that has more than one place of business it is located at its chief executive office.<sup>13</sup>

[28] There are some technical differences in the wording of the Ontario and CCPPSL rules for registered organizations. These differences and the reasons for the CCPPSL formulation are described in detail in the CCPPSL report. The reasons given are persuasive and justify adoption of the CCPPSL wording in Alberta. The CCPPSL rules as enacted in Saskatchewan are as follows:

7(1) In this section

- (d) **‘organization’** means a corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency, or instrumentality, public corporation, or any other legal or commercial entity;

7(4) For the purposes of this section, a debtor is located:

- (b) if the debtor is a corporation or an organization and is incorporated, continued, amalgamated or otherwise organized pursuant to a law of a province or territory of Canada by the filing of a record with or the issuance of a record by the province or territory that is available to the public for inspection or the enactment of legislation, in that province or territory;

<sup>13</sup> See SPPSA, s 7(4)(g).

- (c) if the debtor is a corporation incorporated, continued or amalgamated pursuant to a law of Canada by the filing of a record with or the issuance of a record by Canada that is available to the public for inspection or the enactment of legislation, in the jurisdiction where the registered office or head office of the debtor is located:
  - (i) as set out in the letters patent, articles or other constating instrument, or in or pursuant to the legislation, under which the debtor was incorporated, continued or amalgamated; or
  - (ii) as set out in the debtor's bylaws, if subclause (i) does not apply;

***Key Element***

A debtor that is a Canadian business entity should be located in the jurisdiction in which a legally required public record of their organization, continuation or amalgamation is registered or, if created by legislation, in the legislating jurisdiction.

#### **4. PARTNERSHIPS**

[29] The CCPPSL rules differ from the Ontario rules in their treatment of partnerships. Under the Ontario Act, limited liability partnerships fall within the rule that applies to corporations and other registered organizations. A partnership that is not a limited partnership is located in accordance with a choice of jurisdiction clause contained in the partnership agreement, if any. If no such clause exists, the partnership is located under the residual rule mentioned in the previous section; that is, at its place of business or if it has more than one place of business at its chief executive office. Under the CCPPSL rules, all partnerships fall within the definition of "organization". If the partnership is required by law to be recorded in a public registry, its location will be determined by the rules that apply to organizations. If not, it will fall within the residual rule.

[30] Choice of law rules are designed to provide certainty both to those who deal directly with a debtor and to third parties who do not have access to the debtor's internal records but have a legitimate interest in procuring information about claims against a debtor's property. Under the Ontario rule, third parties may be misled if the assets of a non-limited liability partnership are located in a different jurisdiction from the one designated as the governing law in the partnership agreement. Creditors who are in a position to review the partnership agreement and register their interest accordingly have an unfair advantage over those who do not. While the chief executive office test does not offer perfect

certainty, it allows third parties to ascertain the location of a partnership on the basis of publicly apparent facts. As suggested in the Official Comment to Article 9, quoted earlier, the chief executive office is where persons dealing with a debtor would normally look for credit information on the basis of its apparent operations. Further, a location based on the terms of a partnership agreement is subject to change if the agreement is revised to identify a different governing law. The potential for a change in location effected by agreement of the partners undermines the goal of certainty and facilitates opportunistic manipulation of outcomes by the debtor partnership.

***Key Element***

A debtor that is a partnership should be located in accordance with the rules that apply to organizations generally. A partnership that is organized by a legally required record in a public registry will be located in the jurisdiction in which the registry is maintained. A partnership that is not so organized will be located under the residual location rule for businesses at its place of business or, if it has more than one, at its chief executive office.

## 5. TRUSTS

[31] The CCPPSL rules also differ from those of Ontario in their treatment of trusts.<sup>14</sup> The Ontario Act provides that if the debtor is a trustee or trustees acting for a trust, the debtor is located in the province or territory specified in a governing law clause in the trust instrument, or, in the absence of such a clause, in the jurisdiction in which the administration of the trust is principally carried out.

[32] The CCPPSL rules include a business trust or trust in the definition of “organization”, which means that a trust organized through a legally required registration in a public registry is located under the rules that apply to corporations and other registered organizations. A separate rule applies to a trustee acting for a trust that has only one trustee. If the trustee is an individual with a principal residence in Canada, the trustee is located in their province or territory of residence. If the trustee is a Canadian corporation, the trustee’s location is determined by the rules that apply to Canadian corporations generally – ie in the jurisdiction in which it is registered. Where a trust has more than one trustee but does not fall within the rules applied to registered organizations, the residual rule for business entities will apply – ie the trust as debtor is located at the place of business of the trust or if it has more than one place of business at its

<sup>14</sup> See SPPSA, ss 7(1)(d), 7(4)(f) and (g).

chief executive office. If the trust does not carry on a business, the rules that apply to individuals will apply to the trustees.

[33] The CCPPSL report departs from the Ontario approach with respect to trusts for essentially the same policy reasons given in relation to partnerships. If a trustee debtor is located on the basis of the internal records of the trust, those who have a legitimate need for information regarding the debtor's property but do not have access to internal records will have no independent means by which to ascertain the debtor's location. They will therefore not know where to search to ascertain whether the trust property is subject to the claims of secured creditors. As in the case of a partnership, the place of business or chief executive office rule allows third parties to determine the location of a trust debtor on the basis of publicly known facts. In cases of doubt, potential secured creditors will have to perfect under and take account of the laws of all jurisdictions that might qualify as the location of the chief executive office. However, where a trust has only one trustee, the location of a trustee debtor can be ascertained with certainty under the rules that ordinarily apply to an individual or a corporation, as the case may be.

***Key Element***

A debtor that is a trust should be located in accordance with the rules that apply to organizations generally. A trust that is organized by a legally required record in a public registry will be located in the jurisdiction in which the registry is maintained. A special rule should be provided for trusts that have only one trustee, which should be located in accordance with the rules that apply to individuals and corporations, respectively, depending to the legal character of the trustee. A business trust that does not fall within either the rule for registered organizations or the rule for sole trustee trusts will be located under the residual location rule for businesses at its place of business or, if it has more than one, at its chief executive office.

## **6. UNITED STATES BUSINESS ENTITIES**

[34] The foreign law most likely to be relevant to a dispute falling within the PPSA is the law of an American state. To the extent possible, alignment of the PPSA choice of law rules with those of Article 9 of the UCC will advance certainty and reduce transaction costs for transactions that involve a US debtor. Both the Ontario Act and the CCPPSL report contain rules dealing specifically with the location of registered US business entities. The Ontario rules are based on the choice of law rules of the UCC. However, they do not reflect recent amendments to the UCC and omit some relevant UCC definitional provisions. The CCPPSL rules more closely parallel the rules of the UCC that apply to US

business entities. The rules apply to entities defined as a “registered organization”. The definition of “registered organization” refers to an entity organized by the filing of a “public organic record”, also defined. Like those proposed for Canadian business entities, the UCC rules determine the location of a debtor entity according to the location of a public record confirming its existence rather than by the location of its chief executive office. The CCPSSL rules as enacted in Saskatchewan are set out below:

7(1) In this section:

- (f) **‘public organic record’** means a record that is available to the public for inspection and is:
  - (i) a record consisting of the record initially filed with or issued by a state or the United States of America to form or organize an organization and any record filed with or issued by the state or the United States of America that amends or restates the initial record;
  - (ii) an organic record of a business trust consisting of the record initially filed with a state and any record filed with the state which amends or restates the initial record, if a statute of the state governing business trusts requires that the record be filed with the state; or
  - (iii) a record consisting of legislation enacted by the legislature of a state or the Congress of the United States of America that forms or organizes an organization, any record amending the legislation, and any record filed with or issued by the state or the United States of America that amends or restates the name of the organization;
- (g) **‘registered organization’** means an organization organized solely pursuant to the law of the United States of America or solely pursuant to the law of a state of the United States of America by the filing of a public organic record with, the issuance of a public organic record by or the enactment of legislation by the state or the United States of America and includes a business trust that is formed or organized pursuant to the law of a state if a statute of the state governing business trusts requires that the business trust’s organic record be filed with the state;
- (h) **‘state’** means a state of the United States of America, the District of Columbia, Puerto Rico, the United States Virgin Islands or a territory or insular possession subject to the jurisdiction of the United States of America.

7(4) For the purposes of this section, a debtor is located:

- (d) if the debtor is a registered organization that is organized pursuant to the law of a state, in that state;
- (e) if the debtor is a registered organization that is organized pursuant to a law of the United States of America:
  - (i) in the state that the law of the United States of America designates, if the law designates a state of location;
  - (ii) in the state that the registered organization designates, if the law of the United States of America authorizes the registered organization to designate its state of location, including by designating its main office, home office, or other comparable office; or
  - (iii) in the District of Columbia in the United States of America, if subclauses (i) and (ii) do not apply;

***Key Element***

The location of a debtor that is a registered United States business entity should be determined by rules that correspond with those of Article 9 of the Uniform Commercial Code.

## **7. RESIDUAL RULE FOR OTHER BUSINESS ENTITIES**

[35] The Ontario and CCPPSL rules include a residual rule to determine the location of a business entity that does not fall within one of the more specific rules described above. The residual rule closely resembles the PPSA rule that currently applies to business debtors generally. A debtor that has one place of business is located at that place. The “chief executive office” rule is retained for business debtors that have more than one place of business. Certainty in the application of these rules is advanced by provisions defining “place of business” and “chief executive office”. A “place of business” is a place from which a debtor conducts or manages its affairs. “Chief executive office” means the place from which the debtor conducts or manages the main part of its affairs. The latter definition reflects the interpretation indicated by the Official Comment to Article 9 and supported by U.S. case law.

***Key Element***

The location of a business debtor that does not fall within a more specific rule should be determined under a residual rule. A debtor that has only one place of business should be located at that place. A debtor that has more than one place of business should be located at its chief executive office. Definitions of “place of business” and “chief executive office” should be provided.

## 8. DEATH, INCAPACITY OR DISSOLUTION OF DEBTOR

[36] The Act currently contains no provision confirming that the governing law is not affected by the death or incapacity of an individual debtor or the dissolution or disbandment of a debtor that is an artificial entity. Such a provision is recommended in the CCPPSL report and incorporated in the Saskatchewan Act as follows:

7(5) For the purposes of this section, a debtor continues to be located in the jurisdiction specified in subsection (4) notwithstanding:

- (a) in the case of a debtor who is an individual, the death or incapacity of the individual; and
- (b) in the case of any other debtor, the suspension, revocation, forfeiture or lapse of the debtor's status in its jurisdiction of incorporation, continuation, amalgamation or organization, or the dissolution, winding-up or cancellation of the debtor.

### ***Key Element***

The location of a debtor should not be affected (a) in the case of an individual, by death or incapacity or (b) in the case of a business entity, by its dissolution or disbandment.

## 9. CLARIFYING THE LOCATION OF THE DEBTOR

[37] Adoption of these key elements would require the enactment in Alberta of provisions equivalent to the Saskatchewan provisions reproduced or described above, which in turn implement the rules proposed in the CCPPSL report. We recommend that those provisions be adopted. Recommendation 3 summarizes the primary changes that would be implemented through the new provisions.

### **RECOMMENDATION 3**

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The location of a debtor should be determined as follows:

- (1) a registered organization, such as a corporation, partnership or trust, should be located in the jurisdiction in which the legally required public record of their organization, continuation or amalgamation is registered or, if created by legislation, in the legislating jurisdiction,
- (2) an individual, including a business debtor, should be located at their principal residence, and

- (3) a business entity that does not fall within either (1) or (2) should be located at its place of business or, if it has more than one place of business, in the jurisdiction of its chief executive office.

## **E. Change in Location of the Debtor or the Collateral**

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### **1. CHANGE IN LAW APPLICABLE TO VALIDITY, PERFECTION AND PRIORITY**

[38] Section 7 of the Act identifies the location of the debtor as the factor that determines the law governing security interests in intangibles and mobile goods held as equipment or lease inventory, as well as non-possessory security interests in documentary collateral. Section 5 identifies the location of the collateral as the factor that determines the governing law for security interests in goods that do not fall within section 7 and possessory security interests in documentary collateral. The same factor determines the validity, perfection and the effect of perfection or non-perfection (ie priority) of a security interest.<sup>15</sup> Under both sections 5 and 7, location is determined at the time the security interest attaches.

[39] This approach leaves a gap in determining the applicable law where either the collateral or the debtor, as the case may be, moves from one jurisdiction to another and the collateral is subject to two security interests, one perfected in the original relevant jurisdiction and another perfected in the new jurisdiction. The following scenario illustrates the problem.

SP1 takes a security interest in non-mobile goods owned by D and located in Jurisdiction A. SP1 perfects by registering in Jurisdiction A, which is the governing law. D then moves the goods into Jurisdiction B and gives a security interest to SP2 who perfects by registering in Jurisdiction B.

[40] The law applicable to the validity, perfection and priority of SP1's security interest is the law of Jurisdiction A, since the goods were located there when SP1's security interest attached. However, the law applicable to the validity, perfection and priority of SP2's security interest is the law of Jurisdiction B. What is the result of a priority competition between SP1 and SP2 if the laws of Jurisdiction A and Jurisdiction B differ? Which law applies?

[41] The term "validity" addresses the question of whether a security interest has been created under the relevant law; for example, whether the agreement under which the interest arose is an enforceable contract. It is appropriate to

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<sup>15</sup> See Recommendation 2 regarding "the effect of perfection or non-perfection and the priority" of a security interest.

designate the law governing validity of a security interest as the law that applies when a security interest attaches, and the governing law should not change with a change in the location of the debtor or the collateral. However, a person acquiring an interest in collateral can reasonably expect that the law applicable to perfection and priority is the law identified by the relevant factor when their interest arises – not the law of another unknown jurisdiction. In our hypothetical, SP2 will assume that the law of Jurisdiction B applies, since they may not know that the goods were previously located in Jurisdiction A.

[42] The CCPSL report recommends that sections 5 and 7 be revised to confirm that while the validity of a security interest is governed by the designated law at the time it attaches, issues of perfection and priority are determined by the current location of the collateral or the debtor, as the case may be. In the hypothetical, the law of Jurisdiction A would govern the validity of SP1's interest, but the law of Jurisdiction B would govern the perfection and priority of the security interests held by both parties after the collateral is moved into Jurisdiction B. As summarized by the CCPSL, "the previously applicable law continues to apply unless and until it is displaced by a right acquired after a change in the relevant connecting factor."<sup>16</sup>

[43] This result is accomplished by the following Saskatchewan provisions, incorporating the CCPSL recommendations:

5(1) Subject to sections 6 and 7, the validity of the following is governed by the law of the jurisdiction where the collateral is situated when the security interest attaches:

- (a) a security interest in goods;
  - (b) a possessory security interest in an instrument, a negotiable document of title, money or tangible chattel paper.
- (2) Except as otherwise provided in sections 6 and 7, while collateral is situated in a jurisdiction, the law of that jurisdiction governs the following:
- (a) perfection, the effect of perfection or of non-perfection, and the priority of a security interest mentioned in subsection (1);
  - (b) the effect of perfection or of non-perfection and the priority of a non-possessory security interest in a negotiable document of title, tangible chattel paper, an instrument or money.

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<sup>16</sup> CCPSL Report heading 12(b)(ii).

7(2) The validity of the following is governed by the law of the jurisdiction where the debtor is located when the security interest attaches:

- (a) a security interest in:
    - (i) an intangible;
    - (ii) goods that are of a type that are normally used in more than one jurisdiction, if the goods are equipment or inventory leased or held for lease by a debtor to others; or
    - (iii) electronic chattel paper; and
  - (b) a non-possessory security interest in an instrument, a negotiable document of title, money and tangible chattel paper.
- (3) If the debtor is located in a jurisdiction, the law of that jurisdiction governs:
- (a) perfection, the effect of perfection or of non-perfection, and the priority of a security interest mentioned in clause (2)(a); and
  - (b) perfection of a security interest mentioned in clause (2)(b).

***Key Element***

The validity of a security interest should be determined by the law of the jurisdiction that applies when the security interest attaches and the governing law should not change on relocation of the collateral or the debtor. The perfection and priority of a security interest should be determined by the law of the jurisdiction in which the collateral or the debtor, as the case may be, are presently located. The governing law will therefore change on relocation of the collateral or the debtor to a new jurisdiction.

**2. PRESERVING CONTINUITY OF PERFECTION AFTER A CHANGE IN THE APPLICABLE LAW**

[44] As we have seen, a change in the jurisdiction in which collateral falling within section 5 is located or, in a section 7 case, a change in the jurisdiction of the debtor, will trigger a change in the law that governs the perfection and priority of a security interest. A security interest perfected under the law of the original jurisdiction may become unperfected as a result of the change in governing law, and would lose the priority ranking associated with its perfected status.

[45] For example, SP perfects a security interest in goods held by the debtor as inventory in Saskatchewan by registering in Saskatchewan. The debtor then

moves the goods to Alberta with the result that Alberta law governs perfection of a security interest in the goods. In the absence of a countervailing provision, the security interest would not be treated as perfected in Alberta after the goods have crossed the border, assuming SP has not already registered in Alberta. The same result would follow where a debtor located in Saskatchewan gives a security interest in accounts that is perfected in Saskatchewan, and then moves to Alberta.

[46] The Act includes rules that extend the perfected status of a security interest established in the original jurisdiction into the new jurisdiction, subject to specified restrictions. The rules provide a grace period during which the secured party may maintain the perfected status and associated priority of the security interest by taking steps to re-perfect in the new jurisdiction, provided perfected status has not been lost in the original jurisdiction (eg the registration that established perfection has not expired). The grace period in both cases is 15 days after the secured party has knowledge of the change in jurisdiction or 60 days after the change, whichever comes first.

[47] Subsection 5(2) applies where the applicable law is determined by the location of the collateral. It provides that if the collateral is brought from another jurisdiction into Alberta, a security interest perfected in the first jurisdiction continues perfected in Alberta if the secured party takes steps to perfect in Alberta within the grace period.<sup>17</sup>

[48] Subsection 7(3) applies where the applicable law is determined by the location of the debtor. It provides that if the debtor relocates from one jurisdiction to another, a security interest perfected in the first continues perfected in Alberta if the secured party takes steps to perfect in the new jurisdiction within the specified grace period. The rule also applies if the debtor transfers ownership of the collateral to a person located in another jurisdiction.

[49] The section 7 rule differs from the section 5 rule in that the latter applies only if the collateral is brought from a previous jurisdiction into Alberta. The former applies if the debtor moves into a new jurisdiction or transfers the collateral to a person in a new jurisdiction, regardless of whether that jurisdiction is Alberta. This is anomalous and creates a potential problem if the new

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<sup>17</sup> However, a security interest in goods is subordinate to the interest of a buyer or lessee who acquires their interest during the grace period but before the security interest is perfected in Alberta.

jurisdiction has different reperfexion rules, which may be the case if the new jurisdiction is not a Canadian PPSA jurisdiction.<sup>18</sup>

[50] The CCPPSL report points out that, in principle, an enacting jurisdiction should determine the conditions governing continuity of perfection only where the change in the relevant connecting factor results in the law of that jurisdiction becoming the applicable law, as is currently the case under the section 5 rule. The same approach should be applied to section 7, as well to the corresponding rule in subsection 7.1(6), which applies to a change in the debtor's location where the collateral is investment property.

[51] The report also highlights an anomaly flowing from application of the section 7 rule to a case in which the debtor does not move but transfers the collateral to a person in a different jurisdiction. Under the current rule, a security interest perfected in the debtor's jurisdiction will become unperfected and consequently subordinated to an interest arising in the new jurisdiction if a perfecting step is not taken in that jurisdiction, even if the secured party is unaware of the transfer. This contrasts with the result that would follow if a debtor were to transfer the collateral to another person within Alberta. Under section 51, a security interest perfected before the transfer remains perfected and is not subordinated to a security interest arising after the transfer so long as the secured party does not have knowledge of the transfer.

***Key Element***

The rules under which a security interest perfected in the jurisdiction of the debtor's location continues perfected after the debtor relocates should apply only where the debtor moves from the prior jurisdiction to Alberta. The continued perfection rule should not apply when the debtor does not change jurisdiction but transfers an interest in the collateral to a person located in another jurisdiction.

### **3. SECURITY INTERESTS IN GOODS INTENDED TO BE RELOCATED WITHIN THIRTY DAYS**

[52] Section 6 provides a special rule that applies where the parties to the agreement that creates a security interest in goods that are located in one jurisdiction intend that the goods will be kept in another jurisdiction, and they are actually removed to that jurisdiction within 30 days after the date of attachment. There are two problems associated with this provision.

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<sup>18</sup> For further explanation, see the CCPPSL Report heading II (12)(c).

[53] Subsection 6(1) provides that the validity, perfection and effect of perfection or non-perfection (ie priority) of the security interest is governed by the law of the jurisdiction to which the goods are removed. This rule obliges the secured party to register in the intended location of the goods to achieve perfection. The secured party should have the option of either perfecting under the law of the intended location or perfecting in the original location and taking steps as may be required to continue perfection once the goods have moved.

[54] Subsection 6(2) applies where the law of the initially intended location is not Alberta but the goods are subsequently brought into Alberta. This is inconsistent with the amendments proposed earlier regarding the separation of validity from perfection and priority, and clarification of the law governing perfection and priority when the applicable law changes due to relocation of the debtor or the collateral.<sup>19</sup>

[55] Saskatchewan has remedied these deficiencies by substituting the following provision for section 6:

6(1) Subject to section 7, if the parties to a security agreement that creates a security interest in goods in one jurisdiction understand at the time the security interest attaches that the goods will be kept in another jurisdiction, and the goods are removed to the other jurisdiction for purposes other than transportation through the other jurisdiction not later than 30 days after the security interest attaches, the security interest:

(a) is valid if it is valid pursuant to either the law of the jurisdiction where the goods are located when the security interest attaches or the law of the other jurisdiction; and

(b) may be perfected pursuant to the law of either jurisdiction.

(2) If a security interest mentioned in subsection (1) is perfected in accordance with the law of the jurisdiction to which the goods are removed, the effect of perfection and the priority of the security interest are governed by that law:

(a) before the goods are removed to that jurisdiction; and

(b) while the goods are located in that jurisdiction.

***Key Element***

Where the parties to a security agreement that creates a security interest in goods located in one jurisdiction understand that the goods will be kept in another jurisdiction, the security interest should be considered valid if valid

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<sup>19</sup> See subheading E.1.

under the law of either jurisdiction and the security interest should be considered perfected if perfected under the law of either jurisdiction.

#### **4. CLARIFYING THE RESULT OF CHANGE IN LOCATION OF THE DEBTOR OR THE COLLATERAL**

[56] As we have seen, relocation of the debtor or the collateral from one jurisdiction to another raises the question of whether the law governing validity, perfection and priority of a security interest remains that of the original jurisdiction or becomes the law of the new jurisdiction. The amendments proposed are largely technical amendments designed to resolve uncertainties or anomalies in the current rules governing these issues and produce outcomes that are consistent with the reasonable expectations of those who deal with a debtor. They do not entail a significant change in policy. Enactment of these amendments would implement the provisions recommended in the CCPPSL report and enacted in Saskatchewan.

#### **RECOMMENDATION 4**

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The choice of law rules that determine the validity, perfection and priority of a security interest when the debtor or the collateral moves from one jurisdiction to another should implement the following:

- (1) Perfection and priority should be governed by the law of the jurisdiction in which the collateral or the debtor, respectively, are presently located;
- (2) The rule that governs continued perfection when the debtor relocates should apply only when the debtor moves into Alberta and should not apply to the transfer of an interest in collateral;
- (3) A security interest in goods that are expected to and do move into a jurisdiction other than that in which they are originally located within 30 days of the date of attachment should be valid and perfected if valid and perfected under the law of either the original or the new jurisdiction.

#### **F. Law Applicable to Security Interests in Chattel Paper, a Negotiable Document of Title, an Instrument or Money**

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[57] As we have seen, Sections 5 and 7 set out rules that apply to the validity, perfection and priority of security interests in chattel paper, negotiable documents of title, instruments and money; what we have called documentary collateral in short, since all categories represent physical pieces of paper (and, in

the case of money, metal coins). If the secured party is in possession of the collateral, the case falls within section 5: the security interest is governed by the law of jurisdiction in which the collateral is located. Section 7 applies if the secured party is not in possession: the governing law is the law of the debtor's location.

[58] This presents a potential problem in a priority competition between a possessory and a non-possessory security interest in the same collateral, where the collateral is located in one jurisdiction and the debtor in another. Which law prevails if the laws respectively governing the priority of the possessory interest (based on location of the collateral) and the non-possessory interest (based on location of the debtor) differ? Priority should be governed by the law of the jurisdiction where the collateral is located as this is consistent with the reasonable expectations of parties who take possession of documentary collateral.<sup>20</sup>

[59] The structure of the amended provisions of sections 5 and 7 adopted in Saskatchewan and reproduced under heading E.1 above achieve that result.<sup>21</sup> Clauses 5(1)(b) and 7(2)(b) respectively provide that the validity of a security interest in documentary collateral is governed by the location of the collateral, in the case of a possessory interest, and by the location of the debtor, in the case of a non-possessory interest. For a possessory interest, perfection and priority are also governed by the location of the collateral (s 5(2)(a)). For a non-possessory interest, perfection is governed by the location of the debtor (s 7(3)(b)), but priority is governed by the location of the collateral (s 5(2)(b)).

## **RECOMMENDATION 5**

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The law governing the priority of a security interest in tangible chattel paper, negotiable documents of title, instruments and money should be the law of the jurisdiction where the collateral is located, regardless of whether the security interest is possessory or non-possessory.

<sup>20</sup> This is the approach adopted by the current rules that apply to certificated securities. Clause 7.1(2)(a) provides that the effect of perfection or non-perfection and priority of a security interest in a certificated security is governed by the law of the jurisdiction in which the certificate is located. The rule applies whether the security interest is possessory or non-possessory.

<sup>21</sup> These rules also take into account the recommendations in this report regarding electronic chattel paper. The existing references to "chattel paper" would be amended to refer to "tangible chattel paper" and electronic chattel paper should be brought within the choice of law rules that apply to security interests in intangibles. See CCPSL Report heading II (12)(b)(iii).

## G. Ancillary Amendments

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### 1. APPLICABLE LAW IN THE ABSENCE OF A PUBLIC REGISTRY IN JURISDICTION WHERE DEBTOR IS LOCATED

[60] The Act currently provides a rule that applies where the location of the debtor determines the governing law but that jurisdiction does not provide for public registration of a security interest.<sup>22</sup> A security interest in an account payable in Alberta or a non-possessory security interest in documentary collateral is subordinated to a competing interest if it was not perfected in Alberta before the competing interest arose. This rule may have filled a need before PPSAs or counterpart legislation were widely enacted and registries correspondingly established. It is largely redundant now that all jurisdictions in Canada and the United States have public registration systems for security interests of the kind addressed (as do Australia, New Zealand and many other countries). Further, there are in practice very few situations in which the rule provides meaningful protection to third parties dealing with the debtor.<sup>23</sup> Repeal of the rule would have the advantage of bringing Alberta law in line with that of Ontario and Quebec, and with the newly amended law of Saskatchewan.

***Key Element***

The choice of law rules based on the location of the debtor should apply in the same manner whether or not there is a public registry in the jurisdiction in which the debtor is located.

### 2. ELIMINATION OF RENVOI

[61] The PPSL choice of law rules identify the law of a particular jurisdiction as the law governing the various issues addressed. The reference to “the law of” a jurisdiction is generally understood to include the choice of law rules of that jurisdiction, since they are part of the jurisdiction’s law. This can have the problematic result of creating a renvoi. The rules of the identified jurisdiction might refer the issue back to the law of Alberta, or on to the law of a third jurisdiction (technically a “referral”, though often included within the term “renvoi”). In the first instance, the result is circular: Alberta applies the law of Jurisdiction X, which applies the law of Alberta. In the second, a law other than the one identified by the Alberta Act will apply (ie the law of the third jurisdiction rather than the law of the jurisdiction identified by the choice of law

<sup>22</sup> PPSA, s 7(4).

<sup>23</sup> See further CCPSL Report heading II (12)(e).

rule). Modern legislation generally follows the current view that renvoi is undesirable and should be avoided. That view has already been given effect with respect to the law governing interests in investment property.<sup>24</sup>

[62] This approach simplifies the exercise of determining the law that will apply in a given case and avoids the problems that may arise when the law designated by a choice of law rule itself includes choice of law rules that might produce undesirable results.

***Key Element***

The choice of law rules should be amended to eliminate renvoi. A reference to the law of a jurisdiction in the PPSA's choice of law rules should include the internal law of that jurisdiction, but not its conflict of law rules.

### **3. CLARIFYING THE EFFECT OF FOREIGN LAW**

[63] The law designated by a PPSA rule as the applicable law should not be affected by the internal law of a foreign jurisdiction identified by the rule.

#### **RECOMMENDATION 6**

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The choice of law rules should eliminate renvoi and should apply in the same manner whether or not there is a public registry in the jurisdiction in which the debtor is located.

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<sup>24</sup> PPSA, s 8.1 provides as follows:

8.1 For the purposes of section 7.1 [dealing with the law governing security interests in investment property], a reference to the law of a jurisdiction means the internal law of that jurisdiction excluding its conflict of law rules.



## CHAPTER 3

# Purchase-Money Security Interests

## A. Introduction

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[64] The PPSA creates a special priority rule in favour of a purchase-money security interest [PMSI]. A PMSI is a security interest that is taken by a seller to secure the unpaid purchase price or that is taken by a lender to secure a loan that enables the debtor to acquire a new asset.<sup>25</sup> A PMSI is given priority over another competing security interest even though the PMSI was not the first to be registered or perfected.<sup>26</sup> The creation and preservation of PMSI status is therefore of considerable importance to a secured party. Although the basic operation of the PMSI concept and its associated special priority rule has been relatively trouble-free, there are circumstances where there is uncertainty over the creation and maintenance of PMSI status.

## B. Preservation of PMSI Status

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### 1. ADD-ON CLAUSES

[65] In the simplest case of a PMSI, a secured party is granted a security interest in the new asset that is being financed (the “purchase-money collateral”) and the security interest secures the loan or credit that was incurred in connection with its acquisition (the “purchase-money obligation”). Complications arise if the security agreement contains an “add-on” feature under which the security agreement also creates a security interest in some other property of the debtor to secure the purchase-money obligation. For example, a secured party who makes a loan that enables the debtor to acquire a new bulldozer may be given a security interest in an excavator that the debtor already owns in addition to the bulldozer. The security agreement might also provide that the purchase-money collateral secures some other obligation. For example, a security interest that secures a loan that enables the debtor to acquire a new truck

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<sup>25</sup> PPSA, s 1(1)(II). The definition of “purchase-money security interest” also includes leases for a term of more than one year and commercial consignments, which are transactions that the Act deems to be security interests despite the fact that they do not in substance create a security interest.

<sup>26</sup> PPSA, s 34(2)–(3). In order to take advantage of this super-priority, it is necessary for the holder of the PMSI must complete certain procedural steps. The super-priority is available only where the PMSI is granted by the same debtor.

may also secure some other loan or obligation that is owed by the debtor to the secured party. The issue is whether either of these “add-on” features results in a loss of PMSI status.

[66] The issue first arose in the United States.<sup>27</sup> Some courts took the view that the presence of an add-on feature had the effect of destroying the PMSI status that would otherwise be available to the secured party.<sup>28</sup> This was referred to as the transformation approach. This meant that a PMSI would not arise in either of the above examples. Other courts held that an add-on feature did not result in a loss of PMSI status.<sup>29</sup> Rather, the secured party could claim a PMSI, but only to the extent that the security interest was given in the purchase-money collateral to secure the purchase-money obligation. The add-on feature therefore created an ordinary security interest in respect of the additional collateral or the additional obligation. This was referred to as the dual status approach, since the security agreement gave rise to both a PMSI and an ordinary security interest (non-PMSI). In the first example, the secured party could claim a PMSI in respect of the bulldozer and a non-PMSI in respect of the excavator. In the second example, the secured party could claim a PMSI in the truck in respect of the enabling loan and a non-PMSI in respect of the other obligation. Some courts in Canada have endorsed the dual status approach, but there remains uncertainty on whether this approach will be applied in other provinces and territories.<sup>30</sup>

[67] The matter was resolved in the United States through a legislative provision that codified the dual status approach.<sup>31</sup> The Australia PPSA adopted a similar provision.<sup>32</sup> In 2019, Saskatchewan also adopted this approach through the enactment of the following provision:

2(7) A purchase-money security interest does not lose its status because:

(a) the purchase-money collateral also secures an obligation that is not a purchase-money obligation;

<sup>27</sup> See Bernard A Burk, “Preserving the Purchase-money Status of Refinanced or Commingled Purchase-money Debt” (1983) 35:6 Stan L Rev 1133.

<sup>28</sup> *In Re Manuel*, 507 F (2d) 990 (5th Cir 1975); *Southtrust Bank of Alabama, NA v Borg-Warner Acceptance Corp*, 760 F (2d) 1240 (11th Cir 1985).

<sup>29</sup> *John Deere Co v Production Credit Association of Murfreesboro*, 686 SW (2d) 904 (Tenn Ct App 1984); *In Re Billings*, 838 F (2d) 405 (10th Cir 1988).

<sup>30</sup> *Clark Equipment of Canada Ltd v Bank of Montreal*, [1984] 27 Man R (2d) 54 (CA); *Re Paradise Valley Marine Ltd* (1997), 7 CBR (4th) 252 (BCSC).

<sup>31</sup> UCC § 9-103(f)(1)-(2).

<sup>32</sup> *Personal Property Securities Act 2009* (Cth), 2009/130, s 14(3)-(4) [AUSPPSA].

- (b) collateral that is not subject to a purchase-money security interest also secures the purchase-money obligation...

[68] This provision is desirable for two reasons. First, it dispels any uncertainty over which approach is to be applied. Second, favouring the dual status approach over the transformation approach better accords with the underlying objectives of the PPSA. There may be legitimate commercial reasons for taking additional collateral. For example, the purchase-money collateral may be more highly depreciable. There is also no good commercial reason why a debtor should not be able to use the new asset to secure a different obligation that is owed to the secured party. The add-on feature creates a non-PMSI that is subject to the usual first to register or perfect rule of priority, and therefore competing secured parties are not prejudiced. The ability to create such an interest is consistent with one of the fundamental objectives of modern secured transactions reform – that the law should permit the use of all of the debtor’s assets for credit support.<sup>33</sup>

**Key Element**

A PMSI should not lose its status if the security agreement also secures an obligation that is not a purchase-money obligation or because the security agreement creates a security interest in other collateral to secure the purchase-money obligation.

## 2. DEBT CONSOLIDATION AND REFINANCING

[69] A debt consolidation occurs when two or more obligations owed to a creditor are combined into a single obligation. A refinancing involves the replacement of one loan arrangement with another and will often involve the provision of additional funds by a lender. Courts have had to consider whether PMSI status survives when a purchase-money obligation is combined with another debt or is replaced with another loan arrangement. This is illustrated in the following scenario:

SP makes a loan to D to enable D to acquire a new truck to be used as equipment. One year later, SP agrees to loan an additional \$20,000 to D. The parties agree to a new loan arrangement under which the two loans are combined into a single obligation, and a security interest in the truck is given to SP to secure this consolidated loan obligation.

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<sup>33</sup> United Nations Commission on International Trade Law (UNCITRAL), *UNCITRAL Legislative Guide on Secured Transactions* (New York: United Nations, 2010), at paras 41-59.

[70] This matter was not originally addressed in UCC Article 9 in the United States. Many courts concluded that PMSI status is lost upon paying off the old loan and extending a new one. The purchase-money character of the original loan is extinguished because the proceeds of the new loan are not used to acquire rights in the collateral.<sup>34</sup> In Canada, courts in Saskatchewan have consistently held that a consolidation or refinancing does not result in a loss of PMSI status.<sup>35</sup> However, in Newfoundland and Labrador, one court has cast some doubt on this by referring to the U.S. authorities that take the opposite view.<sup>36</sup>

[71] The preservation of PMSI status better accords with the fundamental objectives of modern secured transactions law. The concept of a PMSI plays a vital role in that it gives the debtor the ability to obtain new sources of financing where this enables the debtor to expand its asset pool through the acquisition of a new asset. A refinancing or loan consolidation may be highly desirable in that a debtor who encounters financial difficulties may be able to negotiate a new payment schedule or obtain additional loans. A loan consolidation may also produce administrative efficiencies for a debtor who will be freed from having to make separate loan repayments in respect of each loan transaction. An approach that extinguishes PMSI status upon a refinancing or consolidation will tend to frustrate refinancing as the secured party may be concerned that to do so would result in a loss of PMSI status.

[72] Article 9 of the UCC was subsequently amended to address this problem.<sup>37</sup> The Australia PPSA introduced a similar provision.<sup>38</sup> The 2019 amendments to the Saskatchewan PPSA also adopted this approach:

2(7) A purchase-money security interest does not lose its status because:

...

<sup>34</sup> See *Matthews v Transamerica Financial Services*, 724 F (2d) 798 (9th Cir 1984) at 800–01 for a review of the authorities. Other courts did not take so strict an approach but held that the preservation or loss of PMSI status really depended on the intention of the parties. See Bernard A Burk, “Preserving the Purchase-money Status of Refinanced or Commingled Purchase-money Debt” (1983) 35:6 *Stan L Rev* 1133, at 1147–50. The difficulty with an approach in which the focus is on intention is that it introduces significant uncertainty.

<sup>35</sup> *Bank of Montreal v Tomlyn* (1989), 84 Sask R 253 (QB); *Battlefords Credit Union Ltd v Ilnicki* [1991] Sask R 7 (CA); *Werner v Royal Bank of Canada*, 2000 SKQB 338.

<sup>36</sup> *Sudbury Credit Union Limited v Ezekiel*, 2010 NLTD 22 at para 23.

<sup>37</sup> UCC § 9-103(f)(3).

<sup>38</sup> AUSPPSA, s 14(5). The provision differs in that it provides that it applies whether or not the refinancing is provided by the same secured party. The additional language is not desirable as the Saskatchewan amendments deal with this issue in a more comprehensive manner that is discussed below in the next section.

- (c) the purchase-money obligation has been renewed, refinanced, consolidated, or restructured.

This provision would be of even greater value in Alberta since the matter has not yet been considered by Alberta courts.

***Key Element***

A PMSI should not lose its status because the purchase-money obligation has been renewed, refinanced, consolidated, or restructured.

### 3. THE DUAL STATUS APPROACH

[73] Adoption of these key elements would require the enactment in Alberta of provisions equivalent to the Saskatchewan provisions reproduced above. We recommend that those provisions be adopted. Recommendation 7 summarizes the primary changes that would be implemented through the new provisions.

#### **RECOMMENDATION 7**

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A purchase-money security interest [PMSI] should not lose its status if the security agreement also secures an obligation that is not a purchase-money obligation, the agreement creates a security interest in other collateral to secure the purchase-money obligation, or the purchase-money obligation has been renewed, refinanced, consolidated, or restructured.

### **C. Inventory**

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[74] A secured party may finance a debtor's acquisition of inventory through a series of transactions. This is illustrated in the following scenario:

SP sells 50 kitchen sinks to D for \$25,000 under a secured instalment purchase agreement. The following month, SP sells 200 kitchen faucets to D for \$10,000 under a secured instalment purchase agreement. D operates retail hardware stores and holds the goods as inventory. Both security agreements provide that the security interest secures not only the obligation relating to the goods sold pursuant to the agreement, but also any obligations arising from other agreements.

[75] The dual status approach gives SP a security interest in the sinks to secure the obligation owing in respect of the faucets, but it does not give it the status of a PMSI. Similarly, it gives SP only a non-PMSI in the sinks to secure the unpaid purchase price of the faucets.

[76] This can create serious difficulties for an inventory financier. Over the period of the relationship, there may be many individual transactions. This creates administrative problems as it is necessary to match each payment to a specific agreement in order to ascertain the outstanding purchase-money obligation for each transaction. It may also be difficult or impossible to match an item of inventory with a particular transaction. For example, there may be five separate transactions under which 200 faucets are sold to D. If D has sold 150 of them to customers, it may be impossible to specifically match the 50 remaining faucets to a particular transaction.

[77] The United States introduced a legislative provision that addresses this problem.<sup>39</sup> The 2019 Saskatchewan amendments adopted this approach through the enactment of the following provision:

2(5) A purchase-money security interest in inventory:

- (a) secures any obligation arising out of a related transaction creating an interest mentioned in subclause (1)(jj)(i) or (ii); and [this identifies the purchase-money obligations]
- (b) extends to other inventory in which the secured party holds or held a security interest pursuant to a related transaction that secures or secured an obligation mentioned in subclause (1)(jj)(i) or (ii). [this identifies the purchase-money collateral].
- (6) For the purposes of subsection (5), a transaction is related to another transaction when the possibility of both transactions is provided for in the first transaction or an agreement between the parties entered into before the first transaction.

[78] Subsection 2(5) permits an inventory financier to claim PMSI status in respect of all the purchase-money collateral to secure all the purchase-money obligations. In the above scenario, SP could claim a PMSI in the sinks to secure the purchase-money obligation in respect of the faucets, and a PMSI in the faucets to secure the purchase-money obligation in respect of the sinks. Subsection 2(6) provides that the parties must bargain for this feature in advance through an appropriately worded provision in their transactional documents. It does not allow a secured party to retroactively create this feature if it was not contemplated in relation to the earlier security agreement.<sup>40</sup>

<sup>39</sup> UCC § 9-103(b)(2).

<sup>40</sup> In this respect, the Saskatchewan provision differs from the US provision. The US provision merely requires that the security agreement that creates the PMSI provide that the security interest secure purchase-

## RECOMMENDATION 8

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A secured party who has been given a PMSI in inventory should be able to claim PMSI status in all the inventory that it finances to secure all of the purchase-money obligations that are incurred. This feature should only be available if the parties agree to this on or before the initial transaction.

### D. Paying out PMSIs held by Third Parties

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[79] Recommendation 7 makes it clear that a debt consolidation or refinancing does not result in the loss of PMSI status. The matter can become more complicated if a different lender refinances the transaction. If the lender obtains an assignment of the PMSI from the original secured party, the issue is straightforward as the lender simply steps into the shoes of that party. Difficulties arise if the lender instead pays out the PMSI of the original secured party and is granted a security interest in that collateral by the debtor.

[80] Several Canadian courts have held that a loan that pays out an existing security interest qualifies as a purchase-money loan as it enables the debtor to acquire greater rights in the collateral.<sup>41</sup> This proposition has been heavily criticized by commentators,<sup>42</sup> and has been rejected in New Zealand on the ground that it does not enlarge the debtor's asset pool, but merely allows one security interest to be replaced with another.<sup>43</sup> The view that the security interest that replaces another qualifies as a PMSI in its own right would mean that the refinancing secured party could acquire a higher priority than that afforded to the security interest that it replaced.

[81] This is illustrated in the following scenario:

SP1 is granted a security interest in all of D's present and after-acquired property, and SP1 properly registers a financing statement. SP2 is given a PMSI in an industrial band saw that is acquired by D as equipment, but

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money obligations in respect of other inventory. Suppose that in the scenario, the first security agreement did not contain such a clause, but the second security agreement did. The US provision would give SP a PMSI in faucets that secures the purchase-money obligation in respect of the sinks, but the PMSI in the sinks would not secure the purchase-money obligation in respect of the faucets. In Saskatchewan, no cross-collateralization of PMSIs would be available because it was not provided for in the earlier agreement.

<sup>41</sup> *Battlefords Credit Union Ltd v Ilnicki* [1991] 93 Sask R 7 (CA); *Unisource Canada Inc v Hongkong Bank of Canada* [2000] 131 OAC 24 (ONCA); *Re Gerrard*, (2000), 188 NSR (2d) 224 (SC); *TCC v MacKinnon* (2000) 188 Nfld & PEIR 198 (PEI SC (TD)).

<sup>42</sup> Anthony J Duggan, "Hard Cases, Equity and the PPSA" (2000) 34:1 Can Bus LJ 129; Cuming Walsh & Wood, *Personal Property Security Law*, 2nd ed (Toronto: Irwin Law, 2012) at 461-63 [Cuming Walsh & Wood].

<sup>43</sup> *New Zealand Bloodstock Leasing v Jenkins*, [2007] NZHC 336 at para 58, *aff'd* [2008] NZCA 413.

SP2 fails to register within 15 days of D obtaining possession of the saw with the result that SP1 has priority over SP2. SP3 thereafter pays out SP2, and D grants SP3 a security interest in the saw.

[82] If SP3's security interest qualifies as a PMSI, then SP3 can potentially obtain priority over SP1 despite the fact that SP2's security interest was subordinate to SP1. In order to claim the PMSI super-priority it is necessary for SP3 to register no later than 15 days after D obtains possession of the collateral. Some courts have held that this time period does not begin to run until D obtains possession of the goods as a debtor.<sup>44</sup> The time would therefore not run from the initial date of possession of the saw by D. Rather it would commence when the refinancing transaction between SP3 and D was concluded. Other courts have rejected this approach and have held that it is the initial date of possession that is relevant. On this view, SP3 would be out of time, although it would prevail if D gave up possession of the saw to SP3 prior to the transaction and SP3 thereafter delivered it back to D.<sup>45</sup>

[83] Courts in the United States have adopted a different approach. They have held that by paying out SP2's security interest, SP3 has a right of subrogation that allows it to assert SP2's security interest. The advantage of this approach is that SP3 acquires no greater right than that held by SP2. A disadvantage is that SP3 runs the risk that a party in the position of SP2 who has registered in time to claim the PMSI priority may discharge its registration or fail to renew it, thereby detrimentally affecting SP3's priority ranking.

[84] There is an intolerable level of uncertainty on this question. The 2019 Saskatchewan PPSA amendments bring much needed clarity to this question through the adoption of the following provision:

34(13) A purchase-money security interest is deemed for priority purposes to have been assigned to the secured party who provided value to the debtor pursuant to the refinancing agreement if:

- (a) refinancing of an obligation mentioned in subclause 2(1)(jj)(i) or (ii) occurs pursuant to a refinancing agreement between the debtor and a secured party other than the secured party who provided the credit or value mentioned in those subclauses; and
- (b) either:
  - (i) the original registration relating to the purchase-money security interest securing the obligation is amended to

<sup>44</sup> *Farm Credit Corp v Gannon*, [1993] 110 Sask R 211 (QB).

<sup>45</sup> *MacPhee Chevrolet Buick GMC Cadillac Ltd v SWS Fuels Ltd*, 2011 NSCA 35.

- identify the secured party named in the refinancing agreement as a secured party; or
- (ii) before expiry or discharge of the original registration relating to the security interest, a registration relating to the purchase-money security interest is effected disclosing the secured party named in the refinancing agreement as the secured party, or the security interest is otherwise perfected.

(14) A purchase-money security interest that is deemed to have been assigned as provided in subsection (13) has the same priority it had immediately before the deemed assignment with respect to a competing security interest but, if subclause (13)(b)(ii) applies, is subordinate to advances made or contracted for by the holder of a perfected competing security interest after expiry or discharge of the original registration relating to the purchase-money security interest and before written notice of the deemed assignment is given to the holder

[85] This legislative solution gives SP3 the same rights that it would obtain had SP2 assigned its security interest to SP3. This deemed assignment means that the refinancing secured party is regarded as a successor in interest in respect of the PMSI of the original secured party. It rejects the idea that the paying out of an existing security interest creates a new PMSI.

[86] The Saskatchewan provision deals with one other matter that is illustrated in the following scenario:

SP1 is granted a security interest in all of D's present and after-acquired property, and SP1 properly registers a financing statement. SP2 is given a PMSI in a seed crusher acquired by D as equipment, and SP2 registers within 15 days of D obtaining possession of the seed crusher with the result that SP2 has priority over SP1. SP3 thereafter pays out SP2, and D grants SP3 a security interest in the seed crusher.

[87] If SP2 cooperates and amends the registration to disclose SP3 as the secured party, then nothing else is required to be done. Alternatively, SP3 may register a new financing statement. This gives SP3 a means of protecting its priority if SP2 is uncooperative. However, there is a risk that SP1 might not realize that an existing PMSI is being refinanced by SP3. SP1 might believe that SP3's registration relates to a non-PMSI security interest, and that SP1 would have priority over it by virtue of its earlier registration. For this reason, SP3 is required to notify SP1 that its registration relates to the refinancing of SP2's PMSI. A failure to do so will result in a subordination of SP3 in respect of any loan advances that are made or agreed to be made by SP1 until SP1 is notified.

## **RECOMMENDATION 9**

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A secured party who pays out a PMSI held by a third party should be deemed to have taken an assignment of the PMSI and should be entitled to register a financing statement in respect of it. The PMSI will retain its priority over an earlier security interest if notice of the refinancing is given to the earlier secured party.

### **E. Allocation of Payments**

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[88] The adoption of the dual status approach means that a security interest may involve both a PMSI and a non-PMSI element. For example, a secured party may be granted a PMSI in a new truck that is being financed but the security agreement may contain an add-on clause so that the truck also secures an additional loan. Similarly, the consolidation of a purchase-money loan with another loan results in the preservation of PMSI status in respect of the purchase-money component of the consolidated obligation but not in respect of the other component. If the debtor makes payments to the secured party, it becomes necessary to determine if they reduce the purchase-money loan or if they reduce the other loan.

[89] This produced considerable uncertainty in the United States if a method of allocation had not been specified by the parties or mandated by statute. Some courts were willing to presume that the parties intended to pay the loans in the order that they were incurred. In order to eliminate this uncertainty, a provision was added to Article 9 of the UCC that provided a formula for the allocation of payments. The Australia PPSA adopted this basic approach but provided a somewhat different formula. Both provide that in the first instance a payment is to be applied according to a method agreed to by the parties. If there is no agreement as to the application of payments, then it is applied according to any direction given by the debtor on or before the time of payment. If the debtor does not indicate how it is to be applied then it is applied according to a statutory formula.

[90] UCC Article 9 provides for the following method of allocation:<sup>46</sup>

1. Unsecured obligations in the order that they were incurred;
2. PMSIs in the order they were incurred.
3. Non-PMSIs (presumably in the order they were incurred).

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<sup>46</sup> UCC § 9-103(e)(3).

[91] The Australia PPSA provides a somewhat different method of allocation:<sup>47</sup>

1. Unsecured obligations in the order that they were incurred;
2. Non-PMSIs in the order they were incurred;
3. PMSIs in the order they were incurred.

[92] The Australia formula better accords with the expectations of the parties, as a secured party would ordinarily wish to preserve its priority status.<sup>48</sup> The 2019 amendment to the Saskatchewan PPSA adopted the Australia PPSA approach through the enactment of the following provision:

2(8) A payment made by a debtor to a secured party must be applied:

- (a) in accordance with any method of application to which the parties agree;
- (b) in accordance with any intention of the debtor manifested at or before the time of the payment if the parties do not agree on a method; or
- (c) if neither clause (a) nor (b) applies, in the following order:
  - (i) to obligations that are not secured, in the order in which those obligations were incurred;
  - (ii) to obligations that are secured, other than those secured by purchase-money security interests, in the order in which those obligations were incurred;
  - (iii) to obligations that are secured by purchase-money security interests, in the order in which those obligations were incurred

[93] The Saskatchewan provision differs from the United States and Australian provisions in one important respect. In the United States and Australia, the use of the formula is limited to instances where “the extent to which a security interest is a purchase-money security interest depends on the application of a payment to a particular obligation.” The Saskatchewan provision is of broader application and would apply whenever there is a secured obligation owed to a creditor and the debtor owes additional secured or unsecured obligations to that

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<sup>47</sup> AUSPPSA, s 14(6)(C).

<sup>48</sup> The provision operates as a default rule that the parties can vary through contract, and in the absence of an agreement it is open to the debtor to specify at the time of payment which obligation the payment is to be allocated against.

creditor. This expanded feature is desirable as it reduces the likelihood of litigation on the issue of the application of payments.

### **RECOMMENDATION 10**

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Where a debtor owes more than one obligation to a secured party and the manner in which payments are to be allocated has not been determined by the parties, payments made by the debtor should be applied first towards unsecured obligations in the order they were incurred, next towards non-PMSIs in the order they were incurred, and finally towards PMSIs in the order they were incurred.

## **F. PMSI in Proceeds of Accounts**

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[94] The special priority that is afforded to a PMSI extends to any proceeds that arise out of a dealing with the collateral.<sup>49</sup> For example, if original collateral that is subject to a perfected PMSI is sold and the debtor receives proceeds collateral from the buyer, the secured party can claim a PMSI in the proceeds collateral. The Alberta Act, in common with the PPSAs in the other western provinces and the territories, provide a limited exception to the PMSI priority rules that would otherwise give the PMSI in the proceeds collateral priority over a competing non-PMSI in that collateral.<sup>50</sup> A secured party who has a PMSI in accounts as proceeds of inventory is subordinate to a secured party who has a security interest in the accounts as original collateral and who has registered or perfected first.<sup>51</sup> The operation of this provision is illustrated in the following scenario:

SP1 is given a security interest on all D's accounts and it registers first-in-time. SP2 is later given a PMSI in all inventory that it supplies to D. SP2 takes the necessary procedural steps to ensure that it obtains the PMSI super-priority. Some of the inventory is then sold to customers giving rise to proceeds in the form of accounts owed by the customers to D. SP1 has priority over SP2's PMSI in the accounts as proceeds collateral.

[95] There is uncertainty concerning the scope of this provision. The Saskatchewan Court of Appeal in *Transamerica Commercial Finance Corp, Canada v Royal Bank of Canada* held that a secured party cannot assert this special priority

<sup>49</sup> PPSA, ss 28(1) and 34(2) and (3).

<sup>50</sup> Ontario and Atlantic Canada take a different approach. Instead of giving SP1 priority over SP2, they require SP2 to notify SP1 of its intention to take a PMSI in inventory thereby alerting SP1 to the fact that it may not have priority over those accounts that are proceeds of the sale of inventory. See Cuming, Walsh & Wood, note 42 at 464–65.

<sup>51</sup> PPSA, s 34(6).

rule in respect of a bank account on which it was liable to the debtor.<sup>52</sup> If, in the scenario, SP1 is a bank and proceeds derived from the sale of inventory are deposited into D's bank account with SP1, SP1 cannot invoke the special priority rule so as to claim priority over SP2. This produces a commercially sensible result. In accounts financing, SP1 assesses its position on the basis of D's trade receivables and not on highly liquid assets such as bank accounts. However, it is by no means clear that courts in other provinces will follow this decision as it involves reading into the provision a qualification that does not appear on its face. Even if the decision is followed, there is further uncertainty on whether the qualification would be extended so as to cover a bank account that is owed to the debtor by some other third party.

[96] The Saskatchewan PPSA resolves this matter in a provision that expressly limits the scope of the special priority rule:<sup>53</sup>

34(7) Subsection (6) [the special priority rule that favours a prior accounts financier] does not apply to an account in the form of a deposit with a deposit-taking institution.

This produces highly desirable clarity on this matter. It also better implements the underlying objective of the special priority rule in favour of accounts financiers.

### **RECOMMENDATION 11**

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The special priority rule that gives a prior accounts financier priority over an inventory financier who claims a proceeds PMSI in accounts should not apply to an account in the form of a deposit with a deposit taking institution.

<sup>52</sup> *Transamerica Commercial Finance Corp, Canada v Royal Bank of Canada* [1990] 84 Sask R 81 (CA).

<sup>53</sup> The PPSAs in the Northwest Territories and Nunavut contain a similar provision.



## CHAPTER 4

## Transferees of Collateral

**A. Payment of Debts and Transfers of Negotiable Property**

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**1. INTRODUCTION**

[97] Section 31 of the PPSA provides rules that govern the priority of a security interest in negotiable and quasi-negotiable property; specifically, money, instruments, negotiable documents of title and chattel paper. The defined term “money” refers to physical currency, not to other monetized forms of value such as funds in a deposit account which may be thought of as money in a non-technical sense.<sup>54</sup> The term “instrument” encompasses cheques and other negotiable instruments, as well as other documents representing a right to payment.<sup>55</sup> “Document of title”<sup>56</sup> and “chattel paper”<sup>57</sup> are also defined. Section 31 is supplemented with respect to unperfected security interests in these types of property by subsection 20(b).

[98] The rules in these provisions are designed to protect those who acquire an interest in property of a kind regarded in commercial practice as negotiable. Traditionally, the objective of negotiability is to facilitate the efficient use of physical paper to transfer value as payment or for other purposes (eg currency and cheques) or as devices for the transfer of underlying property rights (eg documents of title and chattel paper). This is accomplished through rules that allow a transferee who takes possession without knowledge and gives value to acquire the property free of pre-existing security interests: the transferee is not expected or required to conduct a registry search or otherwise investigate to ensure that the property is unencumbered.<sup>58</sup>

<sup>54</sup> PPSA, s 1(1)(cc) “money”.

<sup>55</sup> PPSA, s 1(1)(w) “instrument”.

<sup>56</sup> PPSA, s 1(1)(o) “document of title”.

<sup>57</sup> PPSA, s 1(1)(f) “chattel paper”. This definition, as well as the provisions affecting chattel paper currently in s 31(6), would be changed under the recommendations advanced in Chapter 7 of this report.

<sup>58</sup> The requirement that a transferee give value to defeat a security interest is relaxed in the case of a transfer of money. A gratuitous transferee takes free from a security interest so long as they take without knowledge of the interest. See PPSA, s 31(1)(a).

[99] The following scenarios illustrate the general policy the rules are designed to achieve:<sup>59</sup>

Scenario 1

D grants a security interest in all present and after-acquired personal property to SP to secure a loan. D then makes two purchases, paying Seller A in cash (ie with “money”) and paying Seller B by a cheque payable to Seller B (ie with an “instrument”).

Scenario 2

D is a retail seller of computers, which are purchased from Supplier under a security agreement granting Supplier a security interest in the computers sold to D to secure payment of their price. D sells two computers: one to Buyer A, who pays in cash (ie with “money”) and one to Buyer B who pays by a cheque payable to D (ie with an “instrument”). D deposits the cash and the cheque with Bank.

[100] In Scenario 1, Seller A and Seller B are protected from any claim asserted by SP on the basis of its security interest in the money and the cheque, both of which fall within the scope of SP’s security agreement with D, regardless of whether the security interest is perfected. In Scenario 2, Bank is protected from any claim asserted by the supplier on the basis of its security interest in the money and the cheque as proceeds of the computers.<sup>60</sup> Consequently, ordinary commercial transactions can be accomplished without the need to investigate D’s title to the type of property typically used to effect payment or transfer funds.

## 2. RATIONALIZATION OF PRIORITY RULES

[101] There are three general problems with the existing priority rules in subsection 20(b) and section 31. First, the fact that provisions governing these types of property are found in two non-contiguous sections of the Act has undesirable consequences. Relevant rules may simply be overlooked. Second, the rules are dated in that they deal with security interests in money and instruments but not with rights arising from the transfer of funds by electronic means. Third, the rules are inconsistent in their treatment of different types of negotiable or quasi-negotiable property.

<sup>59</sup> The scenarios do not encompass all the types of transaction that fall within the scope of s 31.

<sup>60</sup> In Scenario 2, Bank would not be protected in the extremely unlikely case that deposit of the cheque constituted a breach of D’s security agreement with SP and Bank had knowledge of that fact. See PPSA, ss 31(3) and (5).

**a. One provision for negotiable collateral**

[102] The rules in section 31 are readily identified by the heading “Protection of transferees of negotiable collateral” but those in section 20, under the heading “Priority of unperfected and certain perfected security interests” can easily be missed. In addition, the separate treatment of unperfected security interests in negotiable property under subsection 20(b) has created anomalous results, presumably through inadvertence. In some instances, a transferee who takes free of a perfected security interest in collateral does not take free of an unperfected security interest in the same property. For example, a person who receives money as a gift takes free of a perfected security interest if he or she does not have knowledge of the security interest,<sup>61</sup> but takes subject to an unperfected security interest.<sup>62</sup> The rules governing the priority of both perfected and unperfected security interests in this type of property should be easily identified and should implement consistent policies. An unperfected security interest should not be given priority over a transferee in circumstances in which a perfected security interest would be subordinated.

[103] This may be accomplished by (i) incorporating reference to unperfected security interests in the provisions of section 31, and (ii) redrafting subsection 20(b) to eliminate reference to money, a negotiable document of title and an instrument, as well as chattel paper (discussed later in this report).<sup>63</sup>

[104] Subsection 20(b) as currently drafted does not require a transferee of negotiable collateral to take possession as a condition of priority over an unperfected security interest. The amendment proposed would bring perfected and unperfected security interests within one rule, with the result that a transferee must take possession of property of this kind in order to have priority over any security interest. This is a minor change and reflects commercial practice in that a transferee will generally take possession of negotiable or quasi-negotiable collateral as a matter of course.

<sup>61</sup> PPSA, s 31(1)(a).

<sup>62</sup> PPSA, s 20(b). A transferee has priority over an unperfected security interest only if they give value.

<sup>63</sup> See SPPSA provisions reproduced under the next heading. A revised section 20 would eliminate reference to chattel paper and would modify the rule as it applies to transferees of goods and intangibles. The revisions relating to chattel paper are addressed in Chapter 7 of this report. The revisions relating to transferees of goods and intangibles are addressed below in this chapter under the heading “The Relevance of Knowledge”.

**Key Element**

The priority rules governing interests in negotiable collateral should be consolidated in one section of the Act. Money, negotiable documents of title, chattel paper and instruments should be deleted from the priority rule that applies to unperfected security interests in competition with transferees.

**b. Transfers of funds**

[105] The PPSA generally implements the principle that transactions with similar function should be treated in the same way. The rights of parties to a transfer of funds, or an interest in funds, should be the same regardless of whether the transfer is effected through money, an instrument or electronic transmission. That policy is not fully achieved in the rules that currently govern negotiable property.

[106] The need to deal with priority competitions arising from electronic funds transfers is obvious as this becomes an increasingly dominant means of making a payment or otherwise transferring funds, and the absence of rules has produced inconsistent judicial decisions.<sup>64</sup> Scenario 2 above illustrates the problem. If D had sold a third computer to Buyer C who paid by electronic funds transfer, there would be no PPSA rule to resolve Supplier's claim against Bank for the amount deposited in D's account. Similarly, the rule that protects a creditor who receives payment of a debt by means of an instrument drawn by a debtor does not extend to a creditor who receives payment of a debt through an electronic transfer of funds initiated by a debtor.<sup>65</sup>

[107] The rules in section 31 should be revised to address the priority of claims to funds transferred electronically. The manner in which the rules are drafted must reflect the fact that an electronic funds transfer is not in itself property, in the way that a cheque is both in itself property and a mechanism for transferring a right to be paid. The rules applicable to electronic funds transfers must

<sup>64</sup> In *Flexi-coil Ltd v Kindersley District Credit Union Ltd* (1993), 113 Sask R 298 (CA) a credit union credited a customer's account in part as a result of the deposit of cheques payable to the customer and in part due to electronic funds transfers initiated by third parties in favour of the customer. One of the customer's suppliers claimed a security interest in the funds deposited by both means. The court extended the PPSA rule governing the transfer of instruments (ie the cheques) to electronic funds transfers, notwithstanding that the language of the provision is it then stood was restricted to instruments. The Saskatchewan Act was subsequently amended to bring electronic transfers within the scope of s 31. In a dispute on comparable facts, the court in *CFI Trust (Trustee of) v Royal Bank of Canada*, 2013 BCSC 1715 rejected the approach taken in *Flexi-coil* on the grounds that the BC statutory rule, like the former Saskatchewan rule, is limited by its terms to instruments.

<sup>65</sup> Both Saskatchewan and Manitoba amended the rule for debtor-initiated payments several years ago to extend its application to electronic funds transfers. The Saskatchewan version of the rule has been replaced by the amendments implementing the CCPSL Report.

therefore speak to interests in the accounts between which the funds are transferred rather than interests in the transfer itself.

[108] Section 31 should also be revised to implement a consistent approach to interests in different types of negotiable property used as a means of transferring funds. Under the current rules, a person who receives a gift of money takes free of a perfected security interest in the money of which they have no knowledge, while a person who receives a gift by way of a cheque is not protected from a perfected security interest in the cheque. Scenario 1 above illustrates the problem. If D gifted \$1,000 to Charity A by the transfer of money and \$1,000 to Charity B by cheque payable to Charity B, Charity A would take the money free of SP's perfected security interest but SP would have priority over Charity B with respect to the cheque.

[109] Section 31 of the Saskatchewan Act has been revised to address these concerns by replacing subsections 31(1) and (2) with the following provisions, which closely track the draft provided in the CCPPSL report.<sup>66</sup>

31(1) In this section, "transferee" does not include a person who acquires a security interest in the money, the account or the instrument.

(2) A transferee of money takes free from a perfected or unperfected security interest in the money if the transferee took possession and

- (a) acquired the money without knowledge that it was subject to the security interest; or
- (b) gave value, whether or not the transferee acquired the money with knowledge that it was subject to the security interest.

(3) Subject to subsection (5), a transferee of funds received by transfer from a deposit account takes free from a perfected or unperfected security interest in the account if the transferee

- (a) acquired the funds without knowledge that the account was subject to the security interest; or
- (b) gave value, whether or not the transferee acquired the funds with knowledge that the account was subject to the security interest.

<sup>66</sup> Subsection (4) would change the structure but not the effect of the rule that currently applies to payment of a debt under PPSA s 31(3). The new provision does not explicitly refer to instruments received in payment of a debt but it confers priority only on a transferee who has given value; for example by the provision of goods or services giving rise to a debt.

- (4) A transferee of an instrument drawn by a debtor and payable to the transferee takes free of a perfected or unperfected security interest in the instrument and in the account on which the instrument is drawn if the transferee took possession of the instrument and
- (a) acquired the instrument without knowledge of the security interest in the instrument or the account; or
  - (b) gave value, whether or not the transferee had knowledge of the security interest in the instrument or the account.

**Key Element**

The rules that govern priority as between a security interest and a transferee of funds should be the same regardless of whether the transfer is achieved by electronic transfer, delivery of money or delivery of an instrument.

**c. Negotiable instruments and documents of title**

[110] The PPSA currently provides separate rules governing security interests in instruments and negotiable documents of title. The rules are intended to operate to the same effect but are formulated in different terms. A “purchaser” who takes possession of an instrument has priority over a security interest perfected by means other than possession if they gave value and acquired the instrument without knowledge of the competing interest. The term purchaser by definition includes a secured party.<sup>67</sup> A “holder” of a negotiable document of title has priority over a security interest perfected by means other than possession if they gave value and acquired the document of title without knowledge of the competing interest. The term holder is not defined but implicitly reflects the meaning of the word as it is used in the *Bills of Exchange Act* and more generally: that is, a person who acquires an interest and is in possession.<sup>68</sup> A secured party who takes possession of a document of title is a holder though the requirement of possession is not expressly stated in the rule.

[111] The different language of the rules that apply to instruments and negotiable documents of title and in particular the term “holder” as used in the latter is potentially misleading and serves no purpose. The revised Saskatchewan Act addresses this concern by consolidating the existing rules of subsections 31(3) and (4) in a redrafted subsection 31(7), reproduced below. Subsection (8)

<sup>67</sup> “Purchaser” includes a person who acquires an interest, including a security interest, under any consensual transaction. See PPSA, ss 1(1)(mm) “purchaser” and (kk) “purchase”.

<sup>68</sup> The definition in the *Bills of Exchange Act*, RSC 1985, c B-4, s 2 is relevant only as an aid to interpretation since it applies only to bills of exchange, not documents of title.

retains the qualified definition of knowledge that currently appears in subsection (5).<sup>69</sup>

31(7) A purchaser of an instrument or a negotiable document of title has priority over a perfected or unperfected security interest in the instrument or document of title if the purchaser:

- (a) gave value for the instrument or document of title;
- (b) acquired the instrument or document of title without knowledge that it is subject to a security interest; and
- (c) took possession of the instrument or document of title.

(8) For the purposes of subsection (7), a purchaser of an instrument or a negotiable document of title who acquired it pursuant to a transaction entered into in the ordinary course of the transferor's business has knowledge only if the purchaser acquired the interest with the knowledge that the transaction violates the terms of the security agreement that creates or provides for the security interest.

***Key Element***

The rules that govern security interests in instruments and in documents of title, respectively, should be merged into a single provision that applies equally to both types of collateral.

**d. Achieving consistency**

[112] The problems identified in the provisions that currently govern negotiable property would be resolved by redrafting section 31 in terms parallel to the Saskatchewan provisions reproduced above. Our recommendation summarizes the effect of the amendments that implement these key elements.

**RECOMMENDATION 12**

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The priority rules governing perfected and unperfected security interests in money, funds transferred electronically, instruments, negotiable documents of title and chattel paper should be consolidated in one section of the Act and rationalized to operate consistently across different forms of collateral.

<sup>69</sup> The effect of both the current and the redrafted provisions is to give a security interest perfected by possession priority over a security interest perfected by any other means, whether by registration or temporary perfection.

### 3. THE POSITION OF DEPOSIT-TAKING INSTITUTIONS

[113] Deposit-taking institutions are in a unique position as creditors because they often have immediate access to funds through which to satisfy a debt through their control of the debtor's deposit accounts. The provisions that apply to a transfer of funds should therefore be qualified to ensure that a deposit-taking institution that is a creditor of its depositor cannot pre-emptively defeat a security interest in funds deposited in the debtor's account by debiting the account to satisfy the debt owed to the institution without the debtor's express authorization.<sup>70</sup> Subsection 31(5) of the Saskatchewan Act responds to that concern. Subsection (6) is designed to ensure that subsection (5) does not restrict the rights of set-off available to a deposit taking institution. An institution that cannot claim priority under section 31 over a security interest in an account from which funds are transferred or in the instrument through which transfer is effected may nevertheless be able to defeat the security interest by exercising rights of set-off recognized in section 41.

31(5) A deposit-taking institution that receives payment of a debt by means of a transfer from or debit to a deposit account of the debtor held by the institution takes free of a security interest in the account only if the payment:

- (a) is authorized by the debtor at or after the time the debt is payable by the debtor to the institution and the authorization of payment is not made by the deposit-taking institution as agent of the debtor;
- (b) is effected through the use of a post-dated cheque drawn by the debtor; or
- (c) is made pursuant to a written authorization that is:
  - (i) executed by the debtor as part of a loan pursuant to which the debtor became indebted to the deposit-taking institution,
    - (A) sets out specified amounts to be debited to or transferred from the deposit account at specified times or intervals; or
    - (B) authorizes debits to or transfers from the deposit account when the credit in the deposit account exceeds an amount specified in the written authorization; and

<sup>70</sup> Saskatchewan and Manitoba added similar provisions to their PPSAs several years ago to deal with this issue.

- (ii) not made by the deposit-taking institution as agent of the debtor.

(6) Nothing in subsection (5) detracts from the rights of an account debtor provided in section 41.

### **RECOMMENDATION 13**

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A deposit-taking institution that is a creditor of its depositor should defeat a security interest in the funds or the source of funds in the depositor's account only when allocation of funds in the account to payment of a debt owed to the institution is expressly authorized by the depositor in the manner specified. This rule should not preclude the exercise of rights of set-off otherwise recognized by the Act.

## **B. The Priority of Buyers and Lessees**

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### **1. INTRODUCTION**

[114] The PPSA contains a number of priority rules that give a transferee of collateral priority over a security interest. These rules are designed to protect those who might acquire property from a debtor in circumstances in which they are unlikely to know or discover that the property is encumbered by a security interest, or where they would otherwise reasonably expect to acquire clear title without checking the registry or taking steps to protect their interest. Subsection 20(b) applies to a transfer of listed types of collateral to a “transferee” other than a secured party, who will most often be a buyer but may include a lessee in the case of goods. Section 30 provides a series of rules protecting buyers or lessees of goods from security interests in the goods. These are often referred to collectively as the “buyer protection rules”.

[115] For the most part, the buyer protection rules have worked well and generated little litigation. However, there are a few points on which they should be revised to eliminate anomalies, update monetary limitations or clarify outcomes.

### **2. THE RELEVANCE OF KNOWLEDGE**

[116] The PPSA buyer protection rules generally grant priority to a buyer (or a lessee of goods) only if they take without knowledge of a security interest in the property acquired from a debtor. We propose that the lack-of-knowledge requirement in subsections 20(b), 30(3) and 30(6) be eliminated.

[117] Subsection 20(b) provides that an unperfected security interest is subordinate to the interest of a transferee of collateral who gives value if the transferee takes without knowledge of the security interest. Subsection 30(6) provides that a buyer or lessee of serial number goods held as equipment takes free of a security interest perfected by registration if the registration does not include the serial number of the goods, provided the buyer or lessee takes without knowledge of the security interest.<sup>71</sup> These rules unduly favour a secured party who has not taken all reasonable measures to ensure that their interest is protected as against other claimants by taking an effective perfecting step or, in the case of serial number goods, including a searchable serial number in their registration. The security interest may be defeated by a transferee of the collateral only if the transferee can prove they did not know of it. Further, the rules in subsections 20(b) and 30(6) are inconsistent with the conditions of priority established by those that govern competing security interests.

[118] An unperfected security interest is subordinate to a perfected security interest, regardless of whether it is known to the holder of the perfected interest.<sup>72</sup> Similarly, a security interest in serial number goods held as equipment that is perfected by means of a registration that does not include the serial number of the goods is subordinate to a security interest perfected by a serial number registration, regardless of whether it is known to the holder of the competing interest.<sup>73</sup> Knowledge on the part of the competing secured party, or the lack thereof, is not relevant in either instance. The same policy should extend to transferees. Priority should not be affected by the happenstance of whether a buyer, lessee or transferee does or does not have knowledge of a security interest in the property acquired. Rather, priority should depend on the actions taken by the secured party to publicize their interest. Only those who take steps to perfect or, in the case of serial number goods, register a searchable serial number should be protected.

[119] The lack-of-knowledge condition in subsections 20(b) and 30(6) also raises difficult issues of proof, since application of the priority rules requires the

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<sup>71</sup> A security interest in serial number goods held as equipment may be perfected by a registration that provides only a general collateral description without the serial number (*Personal Property Security Regulation*, Alta Reg 95/2001, s 34(1)(b) [Regulation]). An interest perfected without serial number has priority over the trustee in bankruptcy and a registered writ but a serial number is required to avoid subordination to competing secured parties and buyers without knowledge.

<sup>72</sup> PPSA, s 35(1)(b).

<sup>73</sup> PPSA, s 35(4) provides that a security interest in serial number goods held as equipment is not considered registered or perfected for purposes of a priority competition falling within the section 35 rules if it is not registered by serial number.

production and evaluation of evidence determining whether the transferee had knowledge of the security interest. The problem is exacerbated by the fact that “knowledge” under the PPSA is not limited to actual knowledge. A person is deemed to have knowledge if they have acquired information under circumstances in which a reasonable person would take cognizance of it.<sup>74</sup> In other words, a transferee may be found to have knowledge if they should reasonably have known of a security interest, even if they in fact did not. The question of whether a person should have known of a security interest can be difficult to answer.

[120] The problem of determining knowledge justifies removal of the lack-of-knowledge requirement in a third priority rule; namely, the rule in subsection 30(3) that protects buyers of low-value consumer goods, often called the “garage sale” rule.<sup>75</sup> Under the current rule, a buyer takes free of a perfected or unperfected security interest in consumer goods worth \$1,000 or less if they take without knowledge of the interest. If challenged by a secured party, the buyer is forced to prove not only that they did not have knowledge of that person’s interest but also that they should not reasonably have known of the interest in the circumstances. The onus imposed by the current rule on unsophisticated consumer buyers and the potential for dispute is not justified by the need to protect secured parties from the risk of loss. Creditors can ameliorate the risk of consumer lending and credit through credit checks, loss distribution, calibrated terms of payment, cross collateralization and other measures.<sup>76</sup>

[121] Elimination of the lack-of-knowledge requirement in subsections 20(b), 30(3) and 30(6) would not promote fraudulent or dishonest conduct. A transferee who acquires their interest in bad faith with knowledge of a security interest is prevented from asserting priority by the general requirement that all rights arising under the Act be exercised in good faith and in a commercially reasonable manner.<sup>77</sup>

[122] The view that these priority rules would function appropriately without a knowledge requirement is validated by the satisfactory operation of comparable rules in the *Convention on International Interests in Mobile Equipment* (which has

<sup>74</sup> PPSA, s 1(2) defines the conditions of knowledge for individuals and artificial entities.

<sup>75</sup> The rule also applies to lessees, though it will rarely be invoked in that context.

<sup>76</sup> We recommend below that the value limit of goods falling within the rule be increased to \$1,500 (Recommendation 15). Such an increase would not materially alter the position of secured creditors.

<sup>77</sup> PPSA, s 66(1). Subsection 65(2) provides that knowledge of a competing interest is not in itself bad faith. However, the use of that knowledge to actively mislead another person may be. See Cuming, Walsh & Wood, note 42 at 496-88.

been ratified by Canada as it applies to interests in aircraft), the New Zealand PPSA<sup>78</sup> and the Civil Code of Quebec,<sup>79</sup> which contain no such requirement.

[123] The Saskatchewan Act has been amended to remove the lack-of-knowledge requirement not only in these rules, but also in the rule that gives a buyer or lessee of goods priority over a temporarily perfected security interest in the goods.<sup>80</sup> This approach ameliorates the problem of proving a buyer's lack of knowledge but penalizes a secured party who has done everything required by the Act to perfect their interest in favour of a buyer who knows or should know of it. We prefer the approach adopted in the CCPPSL report, which does not modify the temporary perfection rule.

#### **RECOMMENDATION 14**

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The requirement that a transferee, buyer or lessee be without knowledge of a security interest to claim priority should be eliminated in the priority provisions respecting unperfected security interests, serial number goods held as equipment, and low value consumer goods.

### **3. THE PRIORITY OF CONSUMER BUYERS AND LESSEES**

[124] Consumers who buy or lease goods from a business seller in the ordinary course of business take free of a perfected or unperfected security interest in the goods under subsection 30(2). Subsection 30(3) extends similar protection to buyers and lessees of low-value goods acquired as consumer goods where the transaction does not fall within section 30(2), on the premise that a person who buys or leases low-value consumer goods in a private transaction should not be expected to protect themselves from the risk that the goods may be encumbered by checking the registry.<sup>81</sup> The rule currently gives priority to a buyer or lessee only when the goods are purchased for a price of \$1,000 or less, or in the case of a lease when the market value of the goods is \$1,000 or less. The \$1,000 value is outdated and does not reflect the devaluation of money and price inflation that has occurred since these provisions were last considered. Further, the

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<sup>78</sup> *Personal Property Securities Act 1999* (NZ), 1999/126, s 52.

<sup>79</sup> *Civil Code of Quebec*, SQ 1991, c 64, Art 2663.

<sup>80</sup> PPSA, s 30(5), SPPSA, s 30(5).

<sup>81</sup> Subsection 30(3) protects consumer buyers and lessees from a security interest given by any previous owner of the goods. Subsection 30(2) protects ordinary course buyers and lessees only from security interests given by the seller or lessor.

designation of a monetary limit in the text of the Act makes it difficult to revise its amount to reflect material economic change.

#### **RECOMMENDATION 15**

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The monetary limit that applies to the priority rule governing low-value sales and leases of consumer goods should be prescribed by regulation and should be increased from \$1,000 to \$1,500.

#### **4. THE REQUIREMENT OF PASSAGE OF PROPERTY TO THE BUYER**

[125] An issue that has been litigated in Canada and elsewhere is whether property must pass to the buyer before the buyer has the status to assert one or more of the rules that permit a buyer to take free of a perfected security interest. The Saskatchewan Court of Appeal in *Royal Bank of Canada v 216200 Alberta Ltd* held that in order to gain the benefit of the ordinary course buyer rule, property in the goods must have passed to the buyer.<sup>82</sup> This position has also been adopted in British Columbia,<sup>83</sup> New Zealand<sup>84</sup> and Australia.<sup>85</sup> The Ontario Court of Appeal in *Spittlehouse v Northshore Marine Inc* rejected this approach and held that it is enough that the goods are identified to the contract, even if property in the goods has not passed to the buyer.<sup>86</sup> The Ontario PPSA was amended in 2006 to codify this approach.

[126] This question should be specifically addressed in the legislation so as to avoid the need for litigation to resolve this point in Alberta. We believe that the passage of property approach is preferable. Sales law plays a crucial role in determining when a buyer acquires a proprietary right in the goods. If property has not passed to the buyer, the buyer merely has a personal right to sue the seller for breach of contract. In the event that the seller goes into bankruptcy, the property of the seller vests in the licensed trustee. The buyer has only a personal right against the seller and therefore cannot recover the goods from the trustee. Similarly, a buyer should not take free of a security interest if the buyer does not have any property right to the goods in question.

[127] The reluctance to apply the passage of property approach in *Spittlehouse* might have been due to the inclusion of a title retention clause in the contract of

<sup>82</sup> *Royal Bank of Canada v 216200 Alberta Ltd* (1986), 51 Sask R 146 (CA).

<sup>83</sup> *Anderson's Engineering Ltd (Re) (Trustee of)*, 2002 BCSC 504.

<sup>84</sup> *ORIX New Zealand Ltd v Milne*, [2006] 3 NZLR 637.

<sup>85</sup> *Warehouse Sales Pty Ltd (in liq) & Lewis and Templeton v LG Electronics Australia Pty Ltd*, [2014] VSC 644.

<sup>86</sup> *Spittlehouse v Northshore Marine Inc* (1994), 18 OR (3d) 60 (CA).

sale which provided that title to the goods did not pass to the buyer until the entire purchase price was paid. The concern may have been that the passage of property approach will preclude a buyer from asserting a buyer rule whenever the sales agreement contains a title retention clause, even if most of the purchase price has been paid. We believe that this is a legitimate concern. We also think that it has been appropriately addressed in the Uniform Commercial Code. Article 2-401(1) provides that a retention of title is limited in effect to a reservation of a security interest. Property in the goods therefore passes immediately to the buyer according to ordinary sales law principles, and the seller has nothing more than a security interest in the buyer's newly acquired goods. The buyer may assert "buyer" status notwithstanding the terms of the contract. This approach is consistent with the manner in which a title retention sales agreement is generally characterized under the PPSA. The interest of the seller is treated as a security interest for purposes of the priority rules, regardless of a contractual provision stipulating that the seller holds title.

[128] The following amendments to section 30 of the Alberta PPSA would implement these changes:

30(1) For the purposes of this section,

- (a) "buyer of goods" means a person who has obtained a transfer of property to goods pursuant to a contract of sale and includes a person who obtains vested rights in goods pursuant to a contract to which the person is a party, as a consequence of the goods' becoming a fixture or accession to property in which the person has an interest;

30(1.1) Any retention or reservation by the seller of title or property in goods that are delivered to the buyer is limited in effect to a reservation of a security interest.

## **RECOMMENDATION 16**

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A person should not be considered to be a buyer of goods under the buyer protection priority rules unless property in the goods has passed to the person. The retention or reservation of title in a contract of sale should be limited in effect to the reservation of a security interest and should not delay transfer of title to the buyer pursuant to the contract.

## 5. FUTURE ADVANCES

[129] A security agreement may provide for periodic advances to the debtor secured by a security interest in identified collateral. Where two or more security interests are in competition, the priority that a security interest has pursuant to the general priority rule applies to all advances, including future advances.<sup>87</sup> However, the Act does not address the priority of a security interest securing a future advance as against a buyer or lessee who acquires an interest in goods subject to the security interest before the advance is made. The outcome of such a priority competition should be settled by express provision.

[130] The following scenario illustrates the approach recommended by comparing a priority competition between security interests in goods with a priority competition between a security interest in goods and a buyer of the goods.

Day 1: D signs a security agreement granting SP1 a security interest in a drill press to secure all advances made by SP1. SP1 perfects its interest by registration and advances \$1,000 to D.

Day 2: D grants a security interest in the drill press to SP2, who perfects by registration.

Day 3: SP1 advances a further \$1,000 to D.

Day 4: D defaults under the agreement with SP1, who seizes the drill press.

[131] Under section 35, SP1's security interest in the drill press has priority over the interest of SP2 to the extent of the cumulative sum of \$2,000, so SP1 is entitled to recover the full amount from the proceeds of a realization sale. However, if on Day 2 D did not grant a security interest to SP2 but instead sold the drill press to Buyer in circumstances under which Buyer took subject to SP1's interest, it is not clear whether SP1 is entitled to enforce its security interest in the drill press only to the extent of the \$1,000 advanced before the drill press was sold or can also recover the \$1,000 advanced on Day 4.

[132] The policy that determines the priority status of a future advance should be the same, regardless of whether the competition is between a security interest securing the advance and another security interest, or between a security interest

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<sup>87</sup> PPSA, s 35(5).

securing the advance and a buyer or lessee of the collateral. The Saskatchewan amendment implements this policy through the following provision:

30(8.1) The priority that a security interest has pursuant to another provision of this Act applies to advances, including future advances, made after the interest of a buyer or lessee arises.

A similar provision should be introduced into the Alberta Act.

#### **RECOMMENDATION 17**

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If a security interest has priority over the interest of a buyer or lessee, the priority should extend to all advances made by the secured party including advances made after the interest of the buyer or lessee arises.

## CHAPTER 5

## Other Priority Rules

**A. Time of Perfection and Bankruptcy**

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[133] The priority rule of the Alberta Act that applies as between an unperfected security interest and the trustee in bankruptcy gives priority to the trustee if the security interest is unperfected “at the date of bankruptcy”. The same rule applies to a liquidator appointed pursuant to the *Winding-up and Restructuring Act* (Canada).<sup>88</sup>

[134] It is not clear how this rule applies when a security interest is perfected on the same day as an assignment in bankruptcy or bankruptcy order but the perfecting act (ordinarily, registration) occurs after the assignment is formally recorded or the order granted.<sup>89</sup> The corresponding rule in some jurisdictions provides that an unperfected security interest is not effective against the trustee if unperfected “at the time of the bankruptcy”. This formulation provides a certain rule, and its adoption in Alberta would promote consistency in outcomes across jurisdictions.

**RECOMMENDATION 18**

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The Act should provide that a security interest in collateral is not effective against the trustee in bankruptcy or a liquidator if the security interest is unperfected at the “time of the bankruptcy” or at the “time the winding-up order is made.”

**B. Effect of Discharge of Registration as Against the Trustee in Bankruptcy**

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[135] A security interest perfected by registration will become unperfected if the registration lapses or is discharged through inadvertence or fraud and, absent provision to the contrary, would consequently lose the priority status based on its registration date. However, the PPSA provides a rule that offers the secured

<sup>88</sup> PPSA, s 20.

<sup>89</sup> The issues were litigated in *Bankruptcy of Tammy Lynn Lloyd*, 2016 MBQB 66, where the court held that the interest of a secured party who registered a financing statement at a later time but on the same date as an assignment in bankruptcy was subordinate to the bankruptcy trustee. The Manitoba PPSA in common with the Alberta Act refers to the “date of bankruptcy” rather than the “time of bankruptcy.”

party a degree of protection against the negative consequences that may accompany lapse or discharge. If the secured party re-registers within 30 days the priority of the security interest is restored as against a security interest that was subordinate at the date of lapse or discharge, except to the extent of advances made by the holder of the subordinate interest before the re-registration was effected.<sup>90</sup>

[136] Re-registration within the 30 day window does not advance the priority of the security interest as against interests that arise during the period of non-registration: the lapsed or discharged interest is treated as unperfected as against new interests if it does not appear on a registry search and priority will depend on the date of the renewed registration. The protection offered by the re-registration rule is accordingly not available as against a trustee in bankruptcy if the debtor becomes bankrupt while the security interest is unregistered and therefore unperfected. The security interest will be ineffective against the trustee even if it is re-registered within 30 days of the date of lapse or discharge.<sup>91</sup> This scenario illustrates the problem:

SP1 holds a security interest in all present and after-acquired personal property of D, perfected by registration on March 1. SP2 holds a security interest in all present and after-acquired personal property of D, perfected by registration on April 1. SP1's registration is inadvertently discharged on August 1. However, SP1 recognizes the error and re-registers on August 25.

[137] SP1's interest has priority over SP2's interest on the basis of its earlier registration.<sup>92</sup> The priority of SP1's security interest over the interest of SP2 is not affected by the temporary lack of registration, except with respect to any advances made by SP2 between August 1 and August 25. However, if D became bankrupt between those dates, SP1's interest would be subordinated to the trustee in bankruptcy and SP1 could only recover as an unsecured creditor in the bankruptcy.<sup>93</sup> The potentially substantial loss suffered by a secured party who acts promptly to correct an inadvertent discharge or lapse is disproportionate to the error, since the trustee in bankruptcy will not have made a risk assessment in reliance on the registry. The trustee's interest arises by operation of law. The loss

<sup>90</sup> PPSA, 35(8).

<sup>91</sup> PPSA, s 20(a)(i). The same rule applies to a liquidator appointed under the *Winding Up and Restructuring Act*, RSC 1985, c W-11.

<sup>92</sup> PPSA, s 35(1)(a)(i).

<sup>93</sup> Since SP2's perfected security interest would be effective against the trustee, SP1 would in effect also be subordinated to SP2.

is particularly unfair if the registration was discharged fraudulently and SP did not become aware of the discharge before bankruptcy intervened.

[138] The proposed changes could be given effect by adding the following provision:<sup>94</sup>

20.1 If registration of a security interest lapses as a result of a failure to renew the registration or is discharged without authorization or in error and the secured party re-registers the security interest not later than 30 days after the lapse or discharge, the lapse or discharge does not affect the priority status of the security interest that existed before the lapse or discharge in relation to a trustee in bankruptcy if the bankruptcy of the debtor occurred after the lapse or discharge and before the re-registration.

### **RECOMMENDATION 19**

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When a security interest is perfected by registration before a debtor becomes bankrupt but the registration lapses or is discharged, the lapse or discharge should not affect the priority of the security interest as against the trustee in bankruptcy if the security interest is re-registered not later than 30 days after the lapse or discharge, even though the re-registration occurs after the time of bankruptcy.

## **C. Time for Determining Priorities**

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[139] Priority as between two security interests is determined according to whether the respective interests are perfected or unperfected and, if perfected, the time of the perfecting step or steps. While perfection may be accomplished by means other than registration, registration is by far the most common and will be the focus of this discussion. However, the issue addressed may also arise when perfection is achieved other than by registration.

[140] The PPSA does not explicitly define the point in time at which priorities are to be determined. In practice, the question of priorities generally arises when the holder of a security interest or another claimant initiates enforcement measures against the collateral. The ranking of competing claims will be determined at that time and the proceeds of an enforcement sale paid out accordingly. Priority also determines the title of a person who acquires the debtor's property in these proceedings. A buyer will not take free of a security

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<sup>94</sup> This parallels the wording of the Saskatchewan amendment except that the Saskatchewan provision also addresses the priority of a judgment enforcement charge that arises during the period of non-registration. We consider the comparable position of a registered writ of enforcement in Chapter 9 of this report.

interest that has priority over the interest of an enforcing creditor unless the holder of the priority interest consents to release it to facilitate the sale.<sup>95</sup>

[141] The determination of priority is not problematic if the perfected status of a security interest in collateral subject to enforcement remains unchanged through to its sale. However, a problem may arise if a security interest that was perfected when enforcement proceedings commenced thereafter becomes unperfected due to a change in the registry. Are priorities fixed at the time enforcement is initiated, or do they change as a result of the change in registration? The cases addressing the question generally involve enforcement through the appointment of a receiver, though the issue may arise when enforcement is initiated directly by a secured party. The following scenario illustrates the issue:<sup>96</sup>

Day 1 SP1 takes a security interest in property of D and perfects by registration.

Day 2 SP2 takes a security interest in the same property and perfects by registration.

Day 20 D defaults under the security agreement with SP1, who appoints a receiver to take possession of the collateral (or enforces by seizing the collateral or equivalent means).

Day 25 SP1's registration lapses and is not reinstated within 30 days or at all.

[142] If priorities are fixed when enforcement is initiated, SP1 will have priority over SP2 and the receiver can sell the collateral to a buyer free of both security interests.<sup>97</sup> If priorities are determined as at the time collateral is sold or disposed of in realization proceedings, SP2 will have priority over SP1<sup>98</sup> and the buyer will take subject to SP2's interest, unless SP2 agrees to relinquish it.<sup>99</sup>

<sup>95</sup> PPSA, s 60(12).

<sup>96</sup> The problem can also arise under different permutations of fact but, for reasons of space, we do not describe other variations. For a more detailed discussion of the issues including additional scenarios see Cuming, Buckwold, Duggan, Walsh, Wood and Bangsund, "Proposals for Changes to the Canadian Personal Property Security Acts" (2017), 59:2 Can Bus LJ 145 at 171-85.

<sup>97</sup> PPSA, s 35(1)(a)(i). Both security interests are perfected by registration: priority goes to the first to register.

<sup>98</sup> PPSA, s 35(1)(b). SP1's security interest is unperfected while SP2's is perfected. A perfected security interest has priority over an unperfected security interest.

<sup>99</sup> *Sperry Inc v Canadian Imperial Bank of Commerce* (1985), 50 OR (2d) 267 (CA), is cited most often for the view that priority is to be determined as at the date of enforcement action and, implicitly, is unaffected by subsequent changes in the registered status of one or more of the competing interests involved. However, the result would have been the same on the facts of the case if the court had concluded that priorities were determined at the time the collateral was sold.

[143] The uncertainty occasioned by lack of an explicit statutory rule should be resolved. Two alternatives may be considered. The first is a rule stating expressly that priorities are fixed at the time an enforcement measure is initiated. The second is a rule stating expressly that priorities are not affected by enforcement action. The second rule entails the implicit result that priorities may be altered by registry changes after an enforcement measure is initiated and before the collateral is sold or assigned to a buyer in enforcement proceedings.

[144] Under the second rule, an enforcing secured party may suffer potentially severe consequences due to an inadvertent loss of registered status that results in subordination of their security interest to another. A party whose interest assumes priority over that of the enforcing creditor will be in a position to block sale of the collateral unless an agreement is reached to pay out their claim first from the proceeds, with the result that the party who has undertaken enforcement proceedings may recover little or none of their claim or even the costs incurred. Although the Act provides that costs of enforcement are payable first from the proceeds of realization, that rule operates in combination with the rule under which a security interest that has priority over that of the enforcing creditor is not affected by the sale.<sup>100</sup> These consequences may be particularly damaging to a secured party who has undertaken realization proceedings through the private or judicial appointment of a receiver, with its attendant complexity and cost.

[145] On the other hand, a rule that would fix priorities at the time an enforcement measure is initiated is inconsistent with the inherent PPSA principle that steps taken towards realization on a security interest do not have priority consequences: priority is determined expressly and, implicitly, exclusively, by the priority rules of the Act. The fact that the Act allows a secured party whose registration has lapsed or been discharged to re-establish priority only under defined circumstances (ie by re-registering within 30 days) suggests that loss of priority due to the loss of registered status is not forestalled by enforcement or other unspecified events.<sup>101</sup>

[146] The initiation of enforcement does not affect a debtor's title to the collateral or preclude the debtor from selling or otherwise dealing with it. From the perspective of risk allocation, this means that a rule allowing the holder of a security interest to assert priority on the basis of a registration that no longer

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<sup>100</sup> PPSA, s 60(1)(a).

<sup>101</sup> PPSA, s 35(8). And see the discussion under heading B above.

exists shifts the risk of loss from the enforcing secured party to those who may deal with the debtor after enforcement has begun. In our scenario, a third party might agree to provide a loan or credit to D sometime after Day 25 on the basis of a registry search that does not disclose the existence of SP1's interest and without knowledge of the enforcement proceedings. Similarly, SP2 might make a further advance in reliance on a clear search result and without knowing of the receivership or seizure. Under a "time of enforcement" rule, third parties could not rely on the registry to accurately evaluate the risk of dealing with the debtor. An enforcing secured party would be allowed to escape a loss that could easily have been avoided by ensuring that their interest is properly registered and that the registration is maintained through to the end of the proceedings.

[147] A rule that would fix priorities at the initiation of enforcement also raises complex problems of statutory drafting and potential uncertainty in application, since it would be necessary to specify the moment at which enforcement is initiated under various types of enforcement measures. For example, in the case of a private receivership, would the material time be the time the receiver agrees to act, the time the debtor receives notice of the appointment, the time the receiver assumes custody or control of the collateral (which itself may be difficult to determine), or some other time? Since no set of rules can determine the moment at which enforcement is initiated and priority fixed with complete certainty, litigation over the application of any rules that might be provided would likely ensue.

[148] Prospective buyers in enforcement sales are affected by the approach adopted. A buyer is offered greater protection by a rule that fixes priorities at the time an enforcement measure is initiated than by the alternative. If priorities are determined at the time collateral is sold, a buyer who buys without conducting an independent registry search and priority assessment could lose the property purchased to a person whose interest has assumed priority over that of the enforcing secured party during the course of the proceedings. In our scenario, a buyer from SP1's receiver would take subject to SP2's security interest if it is not voluntarily discharged, and SP2 could seize the collateral from the buyer. However, a disappointed buyer is not without legal recourse. A buyer who has not accepted a disclaimer of responsibility may seek compensation from a receiver or secured party who has sold the collateral without taking proper steps to ensure clear title.

[149] Each of the rules proposed is accompanied by a risk of loss to some party involved in or affected by proceedings to enforce a security interest. The

Saskatchewan amendments adopt the second approach.<sup>102</sup> On balance, we believe that the party best able to control and avoid the risk of loss is the secured creditor who initiates enforcement and therefore agree that the second approach is to be preferred.

## **RECOMMENDATION 20**

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The priority of a security interest in relation to another security interest in the same collateral should not be affected by enforcement measures taken by the holder of the other security interest.

### **D. Preservation of Set-Off as Against Secured Party Claims**

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[150] The rules of set-off operate as between two persons, each of whom owes to the other an obligation that either is monetary in nature (a debt) or can be ascribed a monetary value (a claim to damages). The law recognizes three general types of set-off; legal set-off, equitable set-off and contractual set-off, each of which carries its own set of rules and restrictions. The law of set-off is complex and its application will depend on several factors including the nature of the reciprocal obligations, the time at which they arose, whether they are inherently connected in some manner, and whether either obligation has been assigned by the original obligee to a third party. We cannot fully explore or comprehensively explain the law of set-off as it may apply to a transaction subject to the PPSA.<sup>103</sup> However, we will illustrate the central issues and approaches discussed through the use of a simple scenario.

#### Basic scenario

A owes \$1000 to B. B owes \$1100 to A. A may set off against the \$1000 debt owed to B the greater amount of \$1100 owed by B to A, with the result that the debt owed by A to B is fully discharged or extinguished and A remains entitled to collect \$100 from B. On the other hand, B may set off against the \$1100 debt owed to A the amount of \$1000 owed by A to B, with the result that the debt owed to A is discharged or extinguished to the extent of \$1,000 and only \$100 remains owing.

<sup>102</sup> See SPPSA, s 35:

35(11) The priority status of a security interest in relation to another security interest in the same collateral as provided in this or any other Act is not affected by enforcement measures taken by the holder of the other security interest.

<sup>103</sup> For further explanation of set-off as it operates in the context of the PPSA, see Cuming, Walsh & Wood, note 42 at 664-68.

[151] The scenario illustrates the fact that set-off in effect gives each party the assurance that the amount owed to them will be recovered to the extent of \$1000 without the need to take legal action. Set-off functions as a self-executing type of payment and may therefore be an important factor in reciprocal agreements between parties.

#### Variation

The scenario remains the same, except that B has granted a security interest in accounts or in property including accounts to C (eg all present and after-acquired personal property), or made an outright assignment of accounts to C.

[152] This variation illustrates the potential intersection of the PPSA and the law of set-off. C either has a true security interest in the account owed by A to B (ie, C can claim payment of the account if B defaults under the security agreement with C), or is deemed by the PPSA to hold a security interest in the account.<sup>104</sup> If C seeks to recover payment of the account from A on the basis of C's security interest in the account, can A defend or deny the claim by asserting the rights of set-off arising from the obligation owed to A by B? Put more simply, is C subject to A's rights of set-off as against B? The question might also be framed in terms of priority. As between A and C, who has priority with respect to the \$1000 owed by A to B? If A is entitled to defeat C's security interest in the account through set-off, A can in effect assert priority over C: A can keep the \$1000 rather than paying it to C. If C is entitled to enforce their security interest in the \$1000 account unaffected by A's rights of set-off against B, C can in effect assert priority over A: A must pay the \$1000 to C and will have to claim against B to recover the full amount of \$1100 owed by B, potentially by suing B. A has lost the advantage of set-off that may have been an inducement to enter into the transaction under which B's obligation arose.

[153] In many though not all cases, A will be a bank or other depository institution (Bank), and B will be a customer (Customer). The \$1000 debt owed by Bank to Customer represents funds deposited by Customer in an account with Bank. The \$1100 debt owed by Customer to Bank represents the outstanding amount owed on a loan or line of credit granted by Bank to Customer. If Customer has given a security interest in the account to a secured party or assignee, C, can Bank assert its right of set-off against C's claim to recover the

<sup>104</sup> An outright assignment of accounts is treated for purposes of the PPSA as a security agreement and the interest of the assignee as a security interest. See PPSA, ss 1(1)(tt)(ii)(A), 3(2)(a).

amount in the deposit account? Put differently, does Bank have priority over C's security interest in the account?

[154] Section 41 of the PPSA confirms that defences and claims that may be asserted by an account debtor (A) against an assignee of the account under principles of law external to the Act are recognized as against a secured party (C).<sup>105</sup> Rights of set-off are implicitly included though not expressly mentioned. In general, an account debtor may assert set-off against an assignee of the account (eg A-bank may assert set-off against secured party C).

[155] Aside from the lack of express reference to set-off, section 41 may be viewed as deficient in two respects. First, it is not entirely clear whether rights of set-off are affected by a security interest in an account that arises by operation of law rather than by agreement between the account creditor (B) and the secured party (C). Secondly, it is not clear how set-off operates in the face of notice of a security interest given to the account debtor (A) by the secured party (C).

[156] The first problem may arise where a secured party claims a security interest in accounts as proceeds. For example, a third party claimant in the position of C may be an inventory financier who claims funds in B's account with A-bank on the basis of the statutory security interest in proceeds conferred by the PPSA.<sup>106</sup> C is not strictly an assignee, since C's interest does not arise pursuant to an agreement with B but by operation of law. However, C's rights as a secured party should be the same whether the security interest arises by agreement or by operation of the PPSA proceeds rule.

[157] The problem of notice follows from the general principle of set-off under which an account debtor is precluded from asserting set-off as against a third party once that party has given notice of their interest in the account. If A is notified of C's interest in the account, A can no longer assert set-off in the account to the extent of C's interest.

[158] The application of this principle is particularly problematic as it applies to banks. It is not clear how notice of secured party C's claim must be given to be effective. Further, in today's highly automated, high-volume banking and payment system, it is difficult for a bank that receives some sort of notification of

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<sup>105</sup> While this discussion is limited to set-off, the Act also recognizes other kinds of defence. For example, if A owes money to B for goods sold and delivered by B, A can defend B's claim for the purchase price by raising deficiencies in the goods, and can assert that defence as against C, a person who holds a security interest in B's accounts.

<sup>106</sup> PPSA, s 28(1)(b).

a secured party's claim to recognize its import, ascertain whether and to what extent funds in a depositor's account are in fact subject to C's alleged interest and take correspondingly appropriate measures to restrict the implementation of account combination mechanisms that may otherwise operate automatically by allocating deposits to reduction of a line of credit or other loan account.

[159] We recommend that section 41 be amended to clarify the rights of set-off that may be asserted by an account debtor as against a secured party. The amendments proposed would follow those enacted in Saskatchewan and would serve four objectives.

[160] First, the amendments would make explicit the implicit effect of the existing provision; that is, they would explicitly recognize that an account debtor's rights of set-off in law and equity may be asserted as against a person claiming a security interest in the account.

[161] Second, the amendments would make it clear that rights of set-off apply as against all those who claim a security interest in an account, whether the interest is created by an agreement or by operation of law.

[162] Third, the amendments would expressly recognize a right of contractual set-off, or account combination. In other words, if parties A and B have agreed by contract to set-off certain reciprocal obligations or to "combine" accounts owing by each to the other, those rights of set-off will be enforceable against a secured party claiming a security interest in the account, subject to a qualified exception in favour of a person claiming the account as proceeds of original collateral.

[163] Finally, the rights of a proceeds claimant as against an account debtor under the exception would be clearly defined. A secured party who claims an account as proceeds would not be subject to an account debtor's right of contractual set-off or account combination if they give a detailed notice of their claim to the account debtor before the proceeds are paid into the account. This is most likely to be relevant where a business customer of a bank deposits in an account proceeds of the sale of inventory or equipment financed by a secured party.

[164] These provisions would serve to clarify the rights of account debtors generally, but would be of particular importance to banks and other depository institutions. They would safeguard the ability of a bank to recover amounts outstanding on loans to borrowers through set-off against amounts held on deposit with the bank by the borrowers. Only in the limited circumstance in

which notice of a proceeds claim is given in the manner specified would rights of set-off be defeated by a secured party claiming an interest in an account.

[165] While the provisions proposed are clearly bank-friendly, they will prompt little real change in the law of set off as it applies to banks or in the recovery of debt by secured creditors through claims against deposit accounts. Banks routinely assert set-off to recover debts owed by their customers notwithstanding that the depositor may have granted a security interest in accounts or in “all present and after-acquired personal property”. The circumstances in which secured party claims can defeat set-off under current law are uncertain as well as limited, and such claims are in practice rarely pursued. Those cases in which secured parties do attempt to recover against deposit accounts often involve claims to the account as proceeds. Claims of that nature may succeed under the proposed amendments, provided the bank is given a notice that is sufficiently detailed to realistically enable bank employees or data systems to recognize that the funds in question are in fact the proceeds subject to the claim.

[166] The primary advantage of the amendments proposed is the furtherance of certainty with respect to competing claims against accounts, particularly though not exclusively in connection with deposit accounts. That certainty in turn responds in large part to concerns raised in recent years regarding the security of deposit accounts as collateral in sophisticated financial transactions, facilitating the liquidity essential to modern financial markets.

[167] Our recommendation would incorporate the amended provisions of the Saskatchewan PPSA as follows:

41(1) In this section:

- (a) ‘account debtor’ means a person who is obligated pursuant to an intangible or chattel paper;
- (b) ‘assignee’ includes a secured party who has a security interest in an intangible or chattel paper as original collateral or as proceeds, and a receiver.

(2) Unless the account debtor has made an enforceable agreement not to assert rights, defences or claims arising out of the contract or a closely connected contract, the rights of an assignee of an intangible or chattel paper are subject to:

- (a) the terms of the contract between the account debtor and the assignor that confer on the account debtor a right of contractual set-off or account combination;

- (b) any defence or claim arising out of the contract or a closely connected contract if the account debtor meets the requirements for set-off or abatement of price; and
- (c) any other defence or claim of the account debtor against the assignor, including set-off, that accrues before the account debtor has knowledge of the assignment.

(2.1) Notwithstanding clause (2)(a), the rights of an assignee who acquires a security interest in an account as proceeds of original collateral are not subject to an account debtor's right of contractual set-off or account combination if:

- (a) the assignee gives a notice to the account debtor before the security interest in the account as proceeds arises that:
  - (i) states that the assignee expects to acquire an interest in the account as proceeds of its original collateral; and
  - (ii) provides details of the instrument, money or transfer of funds that will give rise to the account sufficient to permit the account debtor to reasonably ascertain the account transaction to which it relates; and
- (b) the assignee's security interest in the account as proceeds is continuously perfected.

(2.2) Subsection (2.1) does not operate in favour of the assignee if the account debtor acquires, in addition to its rights, defences and claims as account debtor on the account, a security interest in the account that, pursuant to this Part, has priority over the security interest of the assignee.

(2.3) A notice mentioned in subsection (2.1) may be given in accordance with section 68, but only if notice is given to a deposit-taking institution with respect to a deposit account, notice must be given at the branch of account.<sup>107</sup>

(2.4) For purposes of subsection (2.3), the branch of account:

- (a) is the branch of the deposit-taking institution the address or name of which appears on the specimen signature card or other signing authority signed by the assignor with respect to the deposit account or that is designated by agreement between the deposit-taking institution and the assignor at the time of opening of the deposit account;
- (b) if no branch has been identified or agreed on pursuant to clause (a), is the branch that is designated as the branch of account by

<sup>107</sup> The word "only" in this subsection is likely an error in drafting.

the deposit-taking institution by notice in writing to the assignor;  
or

- (c) if neither clause (a) nor (b) applies, is located at the mailing address identified in written communications between the deposit-taking institution and the assignor relating to the deposit account.

## **RECOMMENDATION 21**

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An account debtor should be permitted to assert any right of set-off in relation to the account against a party claiming a security interest in the account, except where a secured party who claims an interest in the account as proceeds has given a notice of their claim to the account debtor before the security interest attaches setting out information sufficient to enable the account debtor to reasonably ascertain the account transaction to which the claim relates.



## CHAPTER 6

# Registration

## A. Introduction

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[168] The PPSA registry is a notice registration system. This means that it is a notice that a security interest is claimed by the registering party rather than the security agreement itself that is registered. The notice takes the form of a financing statement that records the name and other details of the secured party and the debtor and also records a description of the collateral. A registration can be made before a security agreement is entered into and it can cover more than one security agreement.<sup>108</sup> A registration can be amended or discharged by registration of a financing change statement, although an amendment only takes effect from the time it is made.<sup>109</sup>

[169] Although the statutory provisions governing the registry system are not in need of major reform, there are areas in which amendments are desirable. In some instances, the policies underlying the current design of the registry system should be re-examined in light of past experience. In other instances, judicial decisions concerning the registry system have revealed weaknesses in the wording of the legislation that should be corrected.

## B. Serial Number Registration

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[170] A financing statement contains two fields for the description of collateral – a general collateral field and a serial number field. The Regulations provide a definition of serial number goods.<sup>110</sup> The mere fact that the goods have a unique serial number is not enough. The goods that are within the definition of serial number goods are limited to motor vehicles, trailers, mobile homes, designated manufactured homes, aircraft, boats and outboard motors for boats.<sup>111</sup>

[171] Serial number registration is desirable because a search of the registry by serial number will disclose registrations in respect of security interests in goods

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<sup>108</sup> PPSA, s 43(4)-(5).

<sup>109</sup> PPSA, s 44(3).

<sup>110</sup> Regulation, s 1(1)(y) “serial number goods”.

<sup>111</sup> Further definitions in subsection 1(1) of the regulation define (p) “motor vehicle”, (cc) “trailer”, (o) “mobile home”, (k) “designated manufactured home”, (b) “aircraft” and (e) “boat”.

of this kind granted by former owners. In contrast, a search using the debtor name will only reveal security interests granted by the person whose name is searched and will not disclose those given by a former owner. The provisions of the PPSA that pertain to serial number registration play a very important role, and their effectiveness can be improved through a set of amendments that address some difficulties associated with the design and wording of the current provisions of the PPSA.

[172] The function of serial number registration as a means of discovering security interests through a serial number search underpins the PPSA provisions governing serial number goods. Depending on the category of goods involved, a secured party may be required to include the serial number of goods taken as collateral in order to perfect a security interest in the goods, or to establish the priority of the security interest as against competing claims. The PPSA defines three categories of goods: consumer goods, inventory and equipment.<sup>112</sup> The categories of consumer goods and inventory roughly correspond with the common understanding of those terms. The category of equipment captures any goods that do not fall within the definitions of either consumer goods or inventory.

## 1. CONSUMER GOODS

[173] The Personal Property Security Regulation provides that serial numbers and other details must be included in the serial number field of a financing statement if serial number goods are held as consumer goods.<sup>113</sup> If the serial number is not included the registration will not be effective in perfecting a security interest in the goods. If serial number goods are held as equipment or inventory, the secured party is given the choice of describing them in the serial number field or by providing a more generic description in the general collateral field.<sup>114</sup> For example, a description of the goods as “motor vehicles” is effective in perfecting a security interest in that collateral.

[174] A secured party will typically not choose to describe inventory by serial number as it is very cumbersome to do so. The secured party would need to routinely add serial numbers to its registration as new inventory is acquired and routinely delete existing serial numbers when items of inventory are sold to

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<sup>112</sup> PPSA, s 1(1)(i) “consumer goods”, s 1(1)(p) “equipment”, s 1(1)(y) “inventory”.

<sup>113</sup> Regulation, s 34(1)(a).

<sup>114</sup> Regulation, s 34(1)(b).

customers. A secured party is more likely to provide a serial number description in respect of goods that are held as equipment. Although a description of the collateral in the general collateral field is sufficient to perfect the security interest as against a trustee in bankruptcy or a judgment enforcement creditor, the secured party is subordinate to a competing secured party who describes the collateral by serial number in its registration.<sup>115</sup> The secured party may also be defeated by a buyer if serial number registration is not effected.<sup>116</sup>

[175] The operation of these rules is illustrated in the following scenario:

SP is granted a security interest in D's automobile and D's truck. SP registers a financing statement that describes the collateral as "motor vehicles" in the general collateral field. D holds the automobile as consumer goods and the truck as equipment. D later goes bankrupt.

[176] As against the bankruptcy trustee, SP wins in respect of the truck but loses in respect of the automobile. Serial number registration is required in order to perfect a security interest in consumer goods with the result that SP's security interest is unperfected and ineffective against the bankruptcy trustee.<sup>117</sup> Serial number registration is optional in respect of equipment with the result that SP's security interest wins against the bankruptcy trustee. SP loses in both instances against a buyer without knowledge of the security interest or a competing secured party who registered by serial number.<sup>118</sup>

[177] It is difficult to justify the different treatment of consumer goods (where serial number registration is mandatory) and equipment (where serial number registration is optional though necessary if the competition is with a competing secured party or a buyer without knowledge). The expectation that a searching party will potentially rely on a serial number search of the registry is not present when the competing party is a judgment enforcement creditor or a trustee in bankruptcy.

[178] We recommend that both consumer goods and equipment should be governed by the same rule. This would reduce the level of complexity that is present in the current legislation since the same rule would govern both

<sup>115</sup> PPSA, s 35(4).

<sup>116</sup> PPSA, s 30(6) and (7). The current Act requires that the buyer not have knowledge of the security interest. Recommendation 14 would provide that the buyer prevails regardless of knowledge.

<sup>117</sup> PPSA, s 20(a).

<sup>118</sup> The buyer takes free of the security interest in the automobile under s 20(b) on the basis that an unperfected security interest is subordinate to a buyer without knowledge. The buyer takes free of the security interest in the truck under s 30(6) and (7) by virtue of the secured party's failure to register by serial number notwithstanding that its security interest was perfected pursuant to the Regulations.

situations. It would also simplify matters in that it would be unnecessary to determine in specific cases if the goods were held as equipment or consumer goods.

[179] In order to make this change, it would be necessary to amend three provisions. Section 34 of the Regulations should be amended so as to provide that a secured party has the option of describing the goods by serial number or by a general collateral description regardless of the class of goods that is involved. Subsections 30(7) and 35(4) of the PPSA should be amended so as to make them applicable to both consumer goods and equipment. The result would be that a security interest in both serial number goods and equipment would be perfected by an otherwise valid registration that does not include the serial number (under the amended regulation), but the perfected status would not be recognized in a priority competition with another security interest (under amended subsection 35(4)). A security interest perfected by a registration that does not include the serial number would therefore have priority over the trustee in bankruptcy and judgment creditors but could be subordinated to a security interest perfected by a registration that includes the serial number. Where a registration does not include the serial number the security interest would also be subordinated to a buyer of the goods.

***Key Element***

Registration of serial numbers with respect to serial number goods held as consumer goods should be optional rather than mandatory, and consumer goods should be afforded the same treatment as equipment in relation to priority competitions.

## **2. PURCHASE-MONEY SECURITY INTERESTS**

[180] The PPSA provides that serial number registration is required in order to perfect a security interest in serial number goods held as equipment as against a competing secured party. The Alberta Act in common with the British Columbia Act is deficient in that it fails to impose this requirement as broadly as it should. In particular, the requirement for serial number registration does not apply to a PMSI. This is illustrated in the following scenario:

SP1 is granted a PMSI in D's truck. SP1 registers a financing statement that describes the collateral as "motor vehicle". D holds the truck as equipment. SP2 searches the registry by serial number, and the search result discloses no registrations. SP2 therefore enters into a security agreement with D under which SP2 is granted a security interest in the truck, and SP2 registers a financing statement that describes the collateral by serial number in the serial number field.

[181] SP1 has priority over SP2 despite the fact that SP1's failure to register by serial number meant that its security interest was not be disclosed by a serial number search. This greatly diminishes the usefulness of serial number searches since a secured party who searches by serial number cannot be assured that the search will reveal a PMSI.

[182] This difficulty arises because of the narrow wording of the Alberta Act. Subsection 35(4) provides that serial number registration is required in order to perfect a security interest for the purposes of section 35. This is deficient in that it fails to extend the rule to cover PMSIs that are governed by section 34(2). It is reasonable to assume that the omission was an inadvertent error in the drafting of the Act rather than a policy choice to exclude PMSIs from the serial number registration requirement. This problem has been eliminated in most of the other jurisdictions by simply including a reference to subsection 34(2) in the provision.

**Key Element**

Registration of serial numbers should be required to perfect a PMSI in serial number goods held as equipment or consumer goods as against a competing secured party.

### 3. SERIAL NUMBER DESCRIPTION IN THE GENERAL COLLATERAL FIELD

[183] The provisions of the PPSA that govern serial number registration of equipment contain an unfortunate lack of clarity. The legislation provides for a loss of priority if the goods are "not described by serial number in the registration."<sup>119</sup> Courts in Alberta, Nova Scotia and Prince Edward Island have held that this requirement is satisfied when a secured party records the serial numbers in the general collateral field of a financing statement.<sup>120</sup> This interpretation frustrates the legislative policy behind serial number registration. Serial number registration is required so that searching parties can conduct a search of the registry by serial number in order to discover registrations that have been made in respect of such goods. The difficulty is that a serial number search will only disclose serial numbers that are recorded in the serial number field and will not disclose serial numbers that are recorded in the general collateral field.

[184] This problem is illustrated in the following scenario:

<sup>119</sup> PPSA, s 30(6) and s 35(4).

<sup>120</sup> *Commcorp Financial Services Inc v R & R Investments Corp* (1995), 31 Alta LR (3d) 393 (QB), *WBLI Inc v Maxium Financial Services Inc*, 2003 NSSC 97; *Business Development Bank of Canada v ABN Amro Leasing*, 2003 PESCAD 5.

SP1 is granted a security interest in D's truck which D holds as equipment. SP1 registers a financing statement that records the serial number of the truck in the general collateral field instead of recording it in the serial number field. SP2 searches the registry by serial number and the search result discloses no registrations. SP2 therefore enters into a security agreement with D under which SP2 is granted a security interest in the truck and SP2 registers a financing statement that describes the collateral by serial number in the serial number field.

[185] SP1 has priority over SP2 despite the fact that SP1's failure to register in the serial number field is such that its registration would not be disclosed by a serial number search.

[186] The Acts in Nova Scotia, New Brunswick and Prince Edward Island were subsequently amended to reverse this outcome. They do so by making it clear that the serial numbers and other details must be recorded in the serial number field. The 2019 Saskatchewan amendments introduced a similar change.<sup>121</sup>

***Key Element***

Registration of serial numbers must be effected by registration of the serial number in the field in the financing statement labelled for the receipt of serial numbers.

#### **4. THE PROPOSED LEGISLATIVE PROVISIONS**

[187] The key elements concerning serial number registration are interconnected. They can be given effect through a relatively simple set of amendments set out below:

30(6) If goods are sold or leased, the buyer or lessee takes free from any security interest in the goods that is perfected pursuant to section 25 if the goods were not described by serial number entered into the field labelled for the receipt of serial numbers.

(7) Subsection (6) applies only to goods that are consumer goods or equipment and are of a kind prescribed by the regulations as serial number goods.

35(4) A security interest in goods that are consumer goods or equipment and are of a kind prescribed by the regulations as serial number goods is not registered or perfected by registration for the purposes of subsection (1), (7) or (9) or subsection 34(2) unless a financing statement relating to the security interest that includes a description of the goods by serial number is registered with the serial

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<sup>121</sup> SPPSA, s 30(6) and s 35(4).

number entered into the field labelled for the receipt of serial numbers.

[188] The provisions are broadened to cover consumer goods as well as equipment. Subsection 35(4) is broadened by its extension to PMSIs through the internal reference to subsection 34(2). The provisions make it clear that recording a serial number in the general collateral field of a financing statement does not satisfy the requirement for serial number registration. Subsection 30(6) also implements Recommendation 14 by removing the requirement that a buyer not have knowledge of a security interest in order to take free from it.

## **RECOMMENDATION 22**

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The rules for registration of serial numbers should implement the following policies:

- (1) Serial number registration of serial number goods held as consumer goods should be optional rather than mandatory, and consumer goods should be afforded the same treatment as equipment in relation to priority competitions;
- (2) In a priority competition over serial number goods held as equipment or consumer goods, registration of serial numbers should be required to perfect a security interest, including a PMSI, as against a competing secured party;
- (3) Registration of serial numbers must be effected by registration of the serial number in the field in the financing statement labelled for the receipt of serial numbers.

## **C. Registration Errors**

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[189] The information in a registration may contain errors or omissions. An error or omission does not invalidate a registration unless it is seriously misleading.<sup>122</sup> In determining whether an error is seriously misleading, it is not necessary to show that the person challenging the registration was actually misled by the error.<sup>123</sup> The Act uses an objective test that assesses the validity of the registration on the basis of whether it would mislead a reasonable searching party. Most registration errors that lead to invalidation of a registration involve errors in recording the debtor's name or recording a serial number. The reason for this is that the debtor name and serial number are the two criteria that are

<sup>122</sup> PPSA, s 43(6).

<sup>123</sup> PPSA, s 43(8).

used to conduct registry searches. If there is an error in recording this information, it may mean that a search using the correct debtor name or the correct serial number will not reveal the registration.

[190] The Alberta Court of Appeal in *Case Power & Equipment v MST Trucking Co* developed a test for determining if an error is seriously misleading.<sup>124</sup> Pursuant to this test, an error in recording a serial number makes a registration “seriously misleading” in either of two situations:

- i. it would likely prevent a reasonable search from disclosing the existence of the registration, or
- ii. it would make a person who did somehow become aware of the registration think that it was likely not the same goods in the case of an error in the serial number or likely not the same person in the case of an error in the debtor name.

[191] In order to understand the operation of this test, some further facts about the operation of the registry system are needed. A search of the registry will reveal any registration that exactly matches the debtor name or the serial number used to conduct the search depending on which search criterion is used. It will also disclose as inexact matches registrations that are not exact matches but are made under a name or serial number similar to that used to conduct the search. If the error in the recording of the debtor name or serial number is such that the registration is not disclosed as an exact or inexact match, the first branch of the test comes into play. The registration is seriously misleading because the error prevents a reasonable searching party from discovering the existence of the registration. The second branch of the test comes into play if the registration is disclosed as an inexact match. One cannot conclude from this alone that the registration is valid. Rather, the test is whether a reasonable searching party would suspect that the inexact match involves the same collateral or the same debtor as the collateral or debtor to which the search is directed.

[192] The operation of the second branch of the seriously misleading test is illustrated in the following scenario:

D granted a security interest in D’s Ford truck to SP. SP registered a financing statement that incorrectly set out the serial number by recording a “5” instead of an “S” in the alpha numeric string, and also misidentified the make of the truck as a Toyota rather than a Ford. A

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<sup>124</sup> *Case Power & Equipment v MST Trucking Co* 1994 ABCA 274 at para 65 [*Case Power*].

search of the correct serial number discloses the serial number of the truck as an inexact match.

[193] It is likely that a court would hold that the registration is seriously misleading because the misdescription of the manufacturer would likely cause a reasonable searching party to conclude that the registration did not relate to D's truck.

[194] Unfortunately, a large degree of uncertainty has arisen in connection with this aspect of the seriously misleading test as a result of the decision in *Harder (Bankrupt) v Alberta Treasury Branches*.<sup>125</sup> A secured party in a registration misdescribed the serial number of a motor vehicle held as consumer goods. The error was such that a search using the correct serial number did not disclose the registration. Despite this, the court held that the registration was not seriously misleading. The registration was valid and perfected the security interest, which could therefore be enforced against the debtor's trustee in bankruptcy. The court arrived at this result through its interpretation of the second branch of the *Case Power* test. The court acknowledged that the second branch covers cases where the registration is disclosed as an inexact match, but held that it was not limited to such cases and can include instances where a party acquires knowledge of the registration through other means. The court held that the fact that the debtor informed the bankruptcy trustee of the existence of the security interest before the occurrence of the bankruptcy satisfied this requirement.

[195] The court's conclusion is problematic for three reasons. First, as the two branches of the *Case Power* test are cast as alternatives, a failure of the first branch should have been sufficient to invalidate the registration.<sup>126</sup> Second, the decision in *Harder* shifts the test from an objective test to one that depends on the state of knowledge of the person who seeks to challenge the registration. Third, it misconceives the reason why bankruptcy trustees are given priority over an unperfected security interest. The trustee is not given priority because it conducts a registry search and relies on the result. Rather, the trustee prevails because the occurrence of bankruptcy results in an automatic stay of the enforcement remedies of unsecured creditors. In the absence of the stay, the unsecured

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<sup>125</sup> *Harder v Alberta Treasury Branches*, 2004 ABQB 285.

<sup>126</sup> In *Case Power*, note 124, a search conducted using the correct debtor name did not disclose a registration made using an incorrect name but including the correct serial number for the collateral. Cote JA said this with respect to the registration: "Therefore, the name fails part (i) of the test for seriously misleading. Though it may well pass part (ii), it must pass both. The name is seriously misleading." (at para 51).

creditors could commence writ proceedings that would result in their obtaining priority over unperfected security interests.<sup>127</sup>

[196] New Brunswick, Nova Scotia, Prince Edward Island and Yukon have made amendments to their PPSA in order to introduce greater clarity into the application of the seriously misleading error test.<sup>128</sup> One provision expressly states that a registration is invalid if a search of the registry using the correct debtor name does not disclose the registration. Another provides that a registration is invalid if a search of the registry using the correct serial number does not disclose the registration. These provisions effectively codify the first branch of the *Case Power* test. A third provision provides that the disclosure of a registration as an inexact match does not mean that the registration is, by that fact alone, valid. This codifies the second branch of the *Case Power* test.

[197] An additional benefit of these amendments is that they make it clear that a secured party must ensure both the debtor name and the serial number are free of a seriously misleading error. There has been much litigation on the question of whether a seriously misleading error in a debtor name can be cured by correctly recording the serial number of the goods. Although courts in most jurisdictions, including Alberta, have concluded that the debtor name must always be free of a seriously misleading error,<sup>129</sup> others have concluded that an error in debtor name can be cured by correctly recording the serial number.<sup>130</sup> As a matter of legislative policy, the majority view is preferable. There are several situations in which a searching party may legitimately decide to conduct a debtor name search rather than a serial number search, and it is crucial that the searching party should be able to rely upon the search result that it obtains.

[198] The 2019 amendments to the Saskatchewan PPSA adopt this approach. They also implement the decision to treat consumer goods and equipment the same in relation to the serial number registration rules. The Saskatchewan provisions are set out below:

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<sup>127</sup> *Giffen (Re)*, [1998] 1 SCR 91.

<sup>128</sup> See, for example, *Personal Property Security Act*, SNB 1993, c p-7.1, ss 43(8), (8.1) and (8.2).

<sup>129</sup> *Case Power*, note 124; *Re Kelln (Trustee of) v Strasbourg Credit Union Ltd* [1992] 100 Sask R 164 (CA); *Stevenson v GMAC Leaseco*, 2003 NBCA 26; *Hoskins (Re)*, 2014 NLTD 12; *Robie Financial Inc v Pye*, 2009 NSSC 397; *Bankruptcy of Ramon Presbitero Arnuco*, 2015 MBQB 36.

<sup>130</sup> *Gold Key Pontiac Buick (1984) Ltd v 464750 BC Ltd (Trustee of)*, 2000 BCCA 435; *Re Lambert*, [1994] 20 OR (3d) 108 (CA).

43(7) A registration is invalid if a search of the records of the Registry using the name, as prescribed, of any of the debtors required to be included in the financing statement does not disclose the registration.

(7.1) For the purposes of subsections 30(6) and 35(4), a registration is invalid if a search of the records of the Registry by serial number does not disclose the registration.

(7.2) A registration disclosed other than as an exact match as a result of a search of the records of the Registry using the name of a debtor or serial number as prescribed does not mean that the registration is, by that fact alone, valid.

[199] Subsection 43(7.1) makes it clear that a seriously misleading error in a serial number invalidates a registration only if the priority competition is with another secured party or a buyer. It will not operate against a bankruptcy trustee or a judgment enforcement creditor. The reason for this is that a secured party is able to perfect its security interest in serial number goods by using a general collateral description rather than a serial number description.<sup>131</sup>

### **RECOMMENDATION 23**

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The key principles of the test for seriously misleading errors should be codified in the PPSA, namely:

- (1) A registration should be invalid if a registry search using the correct debtor name does not disclose the registration;
- (2) A registration should be invalid if a registry search using the correct serial number does not disclose the registration in those instances where serial number registration is required for priority;
- (3) The fact that a registration is disclosed other than as an exact match does not by itself mean that a registration is valid.

## **D. Discharge of Unauthorized Registrations**

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[200] Most registrations are made by secured parties in order to perfect their security interests. A written consent or authorization of the debtor is not required. Although this produces a highly efficient registry system that reduces time delays and costs, it can result in abuses. In some instances, the registering party may have a registration in place even though there is no security agreement between the parties. This may happen if the registration is made in

<sup>131</sup> See the discussion above under heading C above.

advance and negotiations between the parties break down so that no security agreement is concluded. It can also occur if the debtor has paid out all of the obligations secured by the security agreement, or if the description of collateral is overly broad in that it covers property in respect of which the debtor has not granted a security interest to the registering party.

[201] The PPSA counters this by giving the debtor the right to require discharge of a registration if all the obligations have been performed or no security agreement was entered into, or amendment of the registration if it is overbroad.<sup>132</sup> The debtor gives a written notice to the registering party that demands the discharge or amendment of the registration. The registering party then has forty days within which to discharge or amend the registration or to provide the Registrar of the Personal Property Registry a court order confirming that the registration need not be amended or discharged. If a registering party fails to either comply with a demand or obtain a court order, the debtor is allowed to discharge or amend the registration on providing to the Registrar satisfactory proof of the demand.

[202] There is one exception to this notice to discharge procedure. If the security agreement is a trust indenture, the person making the demand must obtain a court order authorizing the registration of the discharge or amendment.<sup>133</sup> A trust indenture is used in a transaction under which a person issues secured debt obligations and appoints a trustee for the holders of these debt obligations.<sup>134</sup> This facilitates the public issuance of debt obligations since otherwise each debt holder would be required to separately enforce their debt obligation against the debtor in the event of a default. The exception was made in order to protect debt holders in the event that the trustee inadvertently or negligently fails to obtain a court order confirming a registration after receiving a demand from the debtor.

[203] Unfortunately, the trust indenture exception has been abused. Some registrations are made by persons who have no commercial relationship with the person named as debtor. These nuisance registrations are often made against politicians, judges, government officials and estranged spouses or partners. Some of these registrants have learned that if they indicate on the financing statement that the registration relates to a trust indenture, this will make it more difficult for their victim who will be forced to go to the expense of a court application to

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<sup>132</sup> PPSA, s 50

<sup>133</sup> PPSA, s 50(8) and (9).

<sup>134</sup> PPSA, s 1(1)(vv) "trust indenture".

remove the nuisance registration.<sup>135</sup> Moreover, the concern that indenture trustees will fail to take steps to protect the registration from discharge or amendment now seems misplaced. Although it might have been justified when the PPSA was new and unfamiliar to parties, this no longer holds true as the legislation has been in place for almost three decades. Indenture trustees are sophisticated commercial parties who are remunerated for the obligations that they undertake and are expected to respond appropriately.

[204] Both Saskatchewan and British Columbia have amended their legislation to eliminate the trust indenture exception. They did so by repealing the provisions that create this exception. In Alberta, this would be effected by repealing subsections 50(8) and (9) of the PPSA.

#### **RECOMMENDATION 24**

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The special rule that requires a debtor to seek a court order for the discharge or amendment of a registration if a trust indenture is involved should be eliminated. The usual rule that gives the debtor the right to discharge or amend a registration if a secured party fails to take steps to protect its registration within 40 days should apply instead.

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<sup>135</sup> See *Arnouse v August-Sjodin*, 2014 BCSC 2555.



## CHAPTER 7

# Electronic Chattel Paper

## A. Introduction

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[205] Chattel paper is a new category of personal property that was created when the PPSA came into force. It is a composite of two types of rights: (1) a right to payment of money; and (2) a security interest in or lease of specific goods.<sup>136</sup> Chattel paper financing is prevalent in the automotive and equipment sectors in Canada. It permits a buyer or lessee to arrange both the acquisition and financing of goods from a seller or lessor. The sale or lease contract provides that the seller has a proprietary interest in the goods in the form of a security interest or lease, and also creates a payment obligation usually spread over time. The seller or lessor then transfers these rights to a financial organization that may be associated with the manufacturer or with a bank that carries out this specialized type of financing. The financial organization thereby purchases the chattel paper and pays the seller or lessee the discounted value of the buyer's or lessee's monetary obligation. A seller or lessor can also use its chattel paper as collateral to secure a loan or other obligation.

[206] The PPSA gives chattel paper an element of negotiability. In other words, a person who acquires the original physical documents that evidence the chattel paper without knowledge of a competing claim can obtain a higher ranking claim than a person who had previously been granted an interest in chattel paper. This is illustrated in the following scenario:

SP is granted a security interest in all present and after-acquired property of D to secure a loan and properly effects a registration in the Personal Property Registry. D's assets include chattel paper created as a result of the sale or lease of specific goods to its customers. D later sells its rights to the chattel paper to A and delivers possession of the original documents to A. A did not know of SP's rights.

[207] A has priority over SP if A acquired its right to the chattel paper without knowledge of SP's security interest.<sup>137</sup> It is essential that A acquire physical

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<sup>136</sup> PPSA, s 1(1)(f) "chattel paper".

<sup>137</sup> PPSA, s 31(6). The chattel paper purchaser must take possession in the ordinary course of its business and give new value for it. The chattel paper purchaser is given priority even though it may be aware that the chattel paper is subject to a perfected security interest in the chattel paper as proceeds.

possession of the original “wet ink” sale or lease document between the seller/lessor and the customer in order to assert this priority.

[208] Advances in information technology have produced an environment in which the transfer and storage of paper based documents has become increasingly burdensome for businesses. As with many other areas of business law, solutions that recognize electronic forms of documents may greatly facilitate commercial financing. The concept of electronic chattel paper was introduced in the United States and has recently been adopted in Ontario and Saskatchewan. The challenge was to translate rules that are based on the possession of an original paper document into rules that function in an electronic environment.

## **B. A New Concept of Electronic Chattel Paper**

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### **1. THE DEFINITION OF ELECTRONIC CHATTEL PAPER AND THE MEANING OF CONTROL**

[209] Under the amended law of other jurisdictions, chattel paper of the traditional paper-based variety is defined as “tangible chattel paper”. The new electronic variety is defined as “electronic chattel paper.” The 2019 Saskatchewan amendments set out these definitions as follows:

**‘electronic chattel paper’** means chattel paper created, recorded, transmitted or stored in digital or other intangible form by electronic, magnetic or optical means;<sup>138</sup>

**‘tangible chattel paper’** means chattel paper evidenced by a record consisting of information that is inscribed on a tangible medium;<sup>139</sup>

A reference to chattel paper includes both types.<sup>140</sup>

[210] In order to create an electronic equivalent to tangible chattel paper, it is not sufficient merely to introduce provisions that permit it to exist in an electronic form. It is also necessary to ensure that electronic chattel paper has a uniqueness functionally equivalent to that of an original signed document in respect of tangible chattel paper. The 2019 Saskatchewan amendments introduce this requirement in the following provision:

<sup>138</sup> SPPSA s 2(1)(o.01)

<sup>139</sup> SPPSA s 2(1)(rr.2).

<sup>140</sup> The definition of chattel paper is amended by replacing a reference to “writings” with a reference to “records” so as to clearly encompass both forms of chattel paper.

2(1.2) A secured party has control of electronic chattel paper if the record comprising the chattel paper is created, stored, and transferred in a manner such that:

- (a) a single authoritative record of the electronic chattel paper exists that is unique, identifiable and, except as otherwise provided in clauses (d), (e), and (f), unalterable;
- (b) the authoritative record identifies the secured party as the transferee of the record;
- (c) the authoritative record is communicated to and securely maintained by the secured party or its designated custodian;
- (d) copies of or amendments to the authoritative record that add or change an identified transferee of the authoritative record can be made only with the consent of the secured party;
- (e) each copy of the authoritative record and any copy of a copy is readily identifiable as a copy that is not the authoritative record; and
- (f) any amendment of the authoritative record is readily identifiable as authorized or unauthorized”.

[211] This provision (often referred to as a “safe-harbour” provision) is substantially derived from the current version of Article 9 of the UCC, but it contains one significant modification.<sup>141</sup> Article 9 contains the following general provision in addition to the safe-harbour provision:

9-105(a) A secured party has control of electronic chattel paper if a system employed for evidencing the transfer of interests in the chattel paper reliably establishes the secured party as the person to which the chattel paper was assigned.

[212] This general provision was added in 2010. A secured party may therefore be able to satisfy a court that it has control of electronic chattel paper even though it does not satisfy all of the requirements of the safe harbour provision if it can demonstrate some unspecified degree of reliability in establishing the secured party as the assignee. The CCPPSL Report did not recommend the adoption of a general provision on the ground that it would produce uncertainty and promote litigation. Other commentators have argued that the legislation

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<sup>141</sup> UCC § 9-105(b).

should parallel that of the Uniform Commercial Code through the inclusion of a general provision in order to produce greater flexibility.<sup>142</sup>

[213] The use of electronic chattel paper has become more widespread in the United States. The control requirements are typically satisfied by the use of electronic vaulting technology that stores and manages control of authoritative documents.<sup>143</sup> This technology satisfies the unique, authoritative and identifiable requirements of the safe harbour provision. An advantage of the general provision is that it provides a measure of flexibility that would support the development of future forms of data transmission and storage. The CCPSL Report considered this aspect but concluded that this might be better implemented through regulation.

**Key Element**

Chattel paper should encompass both tangible chattel paper and electronic chattel paper. Electronic chattel paper should be defined as chattel paper created, recorded, transmitted or stored in digital or other intangible form by electronic, magnetic or optical means. In order to utilize the new rules that govern electronic chattel paper, the secured party must have control of it in such a manner as to satisfy specified criteria governing the uniqueness and identifiability of the authoritative record.

## 2. ENFORCEABILITY

[214] In order for a security interest to be enforceable against third parties, the security agreement must either satisfy certain requirements or the secured party must have possession of the collateral. Control of electronic chattel paper by the secured party is functionally equivalent to possession of tangible chattel paper by the secured party. The enforceability requirement should therefore be satisfied if the secured party has control of electronic chattel paper. The 2019 Saskatchewan amendments amend the enforceability provision through the inclusion of the following provision:

10(1) Subject to subsection (2) and section 12.1, a security interest is enforceable against a third party only where:

<sup>142</sup> Eric FW Johnson and David G Gerecke, "Putting the "E" in ECP: Saskatchewan's PPSA Introduces Electronic Chattel Paper" (May 3, 2019) online: *Miller Thomson* <<https://www.millerthomson.com/en/publications/communiques-and-updates/financial-services-insolvency-communique/may-3-2019-financial-services/putting-the-e-in-ecp-saskatchewan-pps-a-introduces-electronic-chattel-paper/>> [<https://perma.cc/WX4E-4AXG>].

<sup>143</sup> See Jane K Winn, "Electronic Chattel Paper: Invitation Accepted" (2010) 46:2 *Gonz L Rev* 407 at 425; Thomas E Plank, "Evolution of Chattel Paper: From Possession to Control" (2014) 46:1 *UCC LJ* 1 at 36.

(c.1)the collateral is electronic chattel paper and the secured party has control pursuant to subsection 2(1.2);

***Key Element***

A security interest in electronic chattel paper should be enforceable against third parties if the secure party has control of it.

### **3. PERFECTION OF SECURITY INTERESTS IN ELECTRONIC CHATTEL PAPER**

[215] Perfection by possession is appropriate only in respect of tangible chattel paper. Section 24 should be amended so as to restrict its application to tangible chattel paper. Tangible chattel paper should also be capable of being perfected by registration as is presently the case.

[216] Finally, a new perfection rule is needed that provides for perfection by control of electronic chattel paper. The 2019 Saskatchewan amendments adopts the following provision:

24.2(1) A security interest in electronic chattel paper may be perfected by control of the collateral pursuant to subsection 2(1.2).

(2) A security interest in electronic chattel paper is perfected by control only when the secured party has control as provided in subsection 2(1.2).

A security interest in electronic chattel paper should also be capable of being perfected by registration, although this risks subordination to a competing secured party.

***Key Element***

Only tangible chattel paper should be capable of being perfected by possession. Electronic chattel paper should be capable of being perfected by control.

### **4. IMPLEMENTING THE NEW APPROACH**

[217] The recognition of electronic chattel paper requires amendments to the PPSA that provide a definition of electronic chattel paper. The amendments should also provide rules governing enforceability and perfection. We proposed the enactment of amendments that closely follow the amendments made in Saskatchewan and Ontario.

## **RECOMMENDATION 25**

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The concept of electronic chattel paper should be adopted. A security interest in electronic chattel paper should be enforceable against third parties if the secured party has control of it, and should be capable of being perfected by control.

### **C. Priority Rules**

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#### **1. AMENDMENTS TO THE PRIORITY RULES**

[218] Under the current PPSA, a purchaser of chattel paper who takes possession of it in the ordinary course of business and for new value takes free of any security interest in it that was perfected by registration if the purchaser did not know of the security interest. This priority rule is not restricted to a buyer but may also be asserted by a secured party, since the definition of purchaser includes a secured party. The 2019 Saskatchewan amendments repeal this provision and replace it with the following provision:<sup>144</sup>

31(9) Subject to subsection (10), a purchaser of chattel paper who takes possession of the tangible chattel paper, or who obtains control of electronic chattel paper as provided in subsection 2(1.2), in the ordinary course of the purchaser's business and for new value has priority over any security interest in the chattel paper if the chattel paper does not indicate that it has been assigned to an identified assignee other than the purchaser.

[219] This provision eliminates the relevance of knowledge on the part of the purchaser. In its place, the outcome will turn on whether the chattel paper has been marked or stamped with an indication that it has been assigned to an identified assignee other than the purchaser. This test is simpler and more easily determined than a test for knowledge that can result in a costly and time-consuming fact finding exercise.

[220] It is also necessary to amend the residual priority rule that determines competitions between competing secured parties when no special priority rule is

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<sup>144</sup> The drafting of the equivalent Ontario provision is preferable in that its paragraphing eliminates ambiguity. The version in the *Personal Property Security Act*, RSO 1990, c P.10 states as follows:

Subject to subsection (3.1), a purchaser of chattel paper has priority over any security interest in it if,

- (a) the purchaser, in the ordinary course of the purchaser's business and for new value,
  - (i) takes possession of the chattel paper if it is tangible chattel paper, or
  - (ii) obtains control of the chattel paper under subsection 1 (3) if it is electronic chattel paper; and
- (b) the chattel paper does not indicate that it has been assigned to an identified assignee other than the purchaser.

applicable.<sup>145</sup> A secured party may have perfected a security interest in electronic chattel paper but may be unable to assert the special priority rule because it did not give new value or did not acquire it in the ordinary course of its business. The 2019 Saskatchewan amendments reformulate the residual priority rule in the following manner:

- (a) priority between conflicting perfected security interests in the same collateral is determined by the earliest of the following occurrences:
  - (i) the registration of a financing statement without regard to the date of attachment of the security interest;
  - (ii) possession of the collateral pursuant to section 24 without regard to the date of attachment of the security interest;
  - (iii) control pursuant to subsection 2(1.2);
  - (iv) perfection pursuant to section 5, 7, 26, 29 or 74”.

***Key Element***

A purchaser who in the ordinary course of the purchaser’s business and for new value takes possession of tangible chattel paper or obtains control of electronic chattel paper should have priority over any security interest in the chattel paper if the chattel paper does not indicate that it has been assigned to an identified assignee other than the purchaser. Control of electronic chattel paper should be added to the events listed in the residual priority rule in relation to competitions between conflicting perfected security interests.

**2. CO-EXISTENCE OF TANGIBLE AND ELECTRONIC CHATTEL PAPER**

[221] A situation may arise where both tangible chattel paper and electronic chattel paper co-exist. This is most likely to occur when tangible chattel paper is converted into electronic chattel paper, but the tangible chattel paper is not marked as a copy or destroyed. The Official Comment to the UCC seems to suggest that the existence of tangible chattel paper may preclude a secured party from being able to perfect with respect to electronic chattel paper by control. If this view is correct, it would mean that a secured party who attempted to perfect by control would be unperfected and therefore subordinate as against most competing claimants.

[222] The 2019 Saskatchewan amendments contain an additional priority rule that has no counterpart in UCC Article 9. It provides as follows:

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<sup>145</sup> PPSA, s 35(1)(a).

31(10) When the rights arising pursuant to tangible chattel paper are transferred to a purchaser as electronic chattel paper and the tangible chattel paper is transferred to another purchaser who takes possession of it for new value and in the ordinary course of that purchaser's business, the interest of the purchaser of the tangible chattel paper has priority over the interest of the purchaser of the electronic chattel paper if the tangible chattel paper does not indicate that it has been assigned to an identified assignee other than the purchaser of the tangible chattel paper.

[223] Under this alternative approach, the co-existence of tangible paper and electronic chattel paper would not result in a loss of perfection by a secured party who perfects by control in respect of the electronic chattel paper. Although a purchaser who acquired the tangible chattel paper in the ordinary course of business and for new value would have priority over the secured party, the secured party would be able to assert a perfected security interest in the chattel paper against judgment enforcement creditors and a bankruptcy trustee.

***Key Element***

The co-existence of both tangible chattel paper and electronic chattel paper should not cause a loss of perfection by control in relation to the electronic chattel paper. A purchaser who takes possession of tangible chattel paper for value and in the ordinary course purchaser's business should have priority over a person who obtains control of electronic chattel paper.

### **3. THE PRIORITY RULES ASSOCIATED WITH ELECTRONIC CHATTEL PAPER**

[224] In order to implement the new concept of electronic chattel paper, it is necessary to amend the priority rules of the PPSA that govern chattel paper. We propose the enactment of amendments that closely follow the amendments made in Saskatchewan and Ontario that make the appropriate adjustments and that also provide a rule that applies when tangible chattel paper and electronic chattel paper co-exist.

#### **RECOMMENDATION 26**

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The priority rules respecting chattel paper should be revised by:

- (1) giving a purchaser of chattel paper priority if the chattel paper is not marked with a notation that it has been assigned to another, rather than making this priority depend on an absence of knowledge;
- (2) adding perfection by control of electronic chattel paper to the residual priority rule that applies to competitions between secured parties; and

- (3) giving a purchaser who takes possession of tangible chattel paper for value and in the ordinary course purchaser's business priority over a person who obtains control of electronic chattel paper in cases where tangible chattel paper and electronic chattel paper co-exist.



## CHAPTER 8

## Other Provisions

### A. Introduction

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[225] In this chapter we consider a handful of unrelated recommendations advanced in the CCPSL report that do not fit within the general topic headings of previous chapters. These recommendations are designed to facilitate ordinary commercial practices and to resolve points of uncertainty in existing law.

### B. Statutory and Contractual Licences

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[226] The PPSA applies to security interests in personal property, as defined by the Act. The definition of “personal property” comprises a list of the categories of collateral recognized in the Act: goods, chattel paper, investment property, a document of title, an instrument, money or an intangible.<sup>146</sup> A supplementary definition is provided for each category. Licences are not expressly included in any defined category, leaving open the question of whether a licence is personal property falling within the scope of the Act. The issue is critically important where the debtor is engaged in a business that requires a licence or quota to do something, use something or sell something as a central aspect of its enterprise. The licence may represent an essential and valuable asset both in itself and, more often, as part of the enterprise as a going concern. For example, a dairy farmer who can offer their milk quota as collateral for a loan may obtain more financial support for the business than would otherwise be possible. Reciprocally, a lender that can take a security interest in the quota along with the cows and milking equipment will benefit by a reduced lending risk, since they will be able to sell an operational dairy in the event of default. Without the quota, the cows and equipment as assets to be separately disposed of would likely have a much lower value.

[227] A licence is not property at common law. However, the legislature may characterize rights as property for the purposes of a particular area of law, notwithstanding that those rights are not otherwise property. An example may be found in the *Civil Enforcement Act*, which defines property to include “any

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<sup>146</sup> PPSA, s 1(1)(gg).

right or interest that can be transferred for value from one person to another.”<sup>147</sup> That definition clearly encompasses rights that are not property at common law.<sup>148</sup> In contrast, the definitional scheme of the PPSA suggests that intangible rights that are not property at common law or in equity are not property under the Act. “Intangible” is defined as “*personal property* other than goods, chattel paper, investment property, a document of title, an instrument or money (emphasis added)”. The implication is that intangible rights, such as those embodied in a licence, are an “intangible” under the Act only if they are personal property as defined by general law.

[228] The question of whether a licence or quota is property for purposes of the PPSA has been litigated in several cases decided in various jurisdictions. Most involve statutory licences granted by a governmental authority, as in the case of the milk quota. However, the same issue can arise in relation to a contractual licence. The licenced use of intellectual property, such as patent rights and trademarks, is a common example.

[229] The authorities provide no clear answer to the question. Some courts have recognized licences as property while others have not. In the 2008 decision in *Saulnier v Royal Bank of Canada*, the Supreme Court of Canada held that a fishing licence is property for purposes of both the PPSA and the *Bankruptcy and Insolvency Act*.<sup>149</sup> Regrettably, the decision did not settle the broader issue; only some types of licence will qualify as property under the reasons given by the Court, and the precise scope of those reasons remains uncertain.

[230] One of the concerns addressed in *Saulnier* is the effect of a limitation on the transferability of a licence as a factor in determining whether the licence is property. Most statutory licences are either not transferrable at all, or transferrable only with the approval of the licensing authority. Similar transfer restrictions may apply to contractual licences. Can a license be property if it cannot be sold and transferred by a secured party seeking to enforce a security interest in the license as collateral without first obtaining the licensor’s approval, which may not be forthcoming?

[231] The effect of transfer restrictions depends on the actual practice of the licensing authority or contractual licensor. Governmental authorities will often approve the transfer of statutory licences or, to the same effect, will cancel a

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<sup>147</sup> *Civil Enforcement Act*, RSA 2000, c C-15, s 1(1)(II)(iii) [CEA].

<sup>148</sup> *Stout & Company LLP v Chez Outdoors Ltd*, 2009 ABQB 444.

<sup>149</sup> *Saulnier v Royal Bank of Canada*, 2008 SCC 58.

licence and issue a new one to the purchaser of a licensed enterprise or activity. Similarly, the transferability of a contractual licence will depend on the willingness of the licensor to permit transfer. The extent to which a licence may be transferred to a buyer of the licence or associated business is a factor in its valuation as an asset of the licensee, but should not determine whether a licence is or is not property for purposes of the PPSA. A lender can consider their potential ability to sell and transfer a licence in the event of the debtor's default, both in the decision to accept the licence as collateral and in the valuation of the licence should they elect to do so.

[232] Legislators in Saskatchewan and British Columbia have responded to the need to settle this issue by amending their definitional scheme to include licences. The definition of "intangible" includes a licence, and a definition of licence is added. Saskatchewan has recently amended its original provisions in that regard, acting on the recommendations in the CCPSL report. Licence is defined as follows:

2(1)(z) '**licence**' means a right, whether or not exclusive:

- (i) to manufacture, produce, sell, transport or otherwise deal with personal property;
- (ii) to provide services; or
- (iii) to acquire personal property;

that is transferrable by the licensee, with or without restriction, or the consent of the licensor, and includes a licence that is subject to cancellation and reissuance by the licensor to another party at the request of either the licensee or the secured party.

[233] The definition recognizes the commercial reality that only transferrable rights can serve as collateral while making it clear that a licence subject to transfer restrictions may be property, since transfer may be possible if the conditions of transfer are satisfied. The closing phrase of the definition ensures that a licence explicitly defined by its terms as non-transferable is nevertheless regarded as transferrable for purposes of the Act if, in practice, the licensor is willing to cancel the licence and reissue it to another party at the request of the licensee or secured party. Alberta should adopt this approach, both to settle the present uncertainty in the law and to enable debtors to leverage the value of these important assets in their financing arrangements.

## **RECOMMENDATION 27**

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The definition of “intangible” should include a licence. The definition of licence should extend to a licence that is transferrable subject to restriction, including a licence that is subject to cancellation and reissuance by the licensor at the request of the licensee or secured party.

### **C. After-Acquired Crops**

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[234] In general, the PPSA allows a creditor to take a security interest in property acquired by the debtor after the security agreement is made. The security interest will attach automatically once the property is acquired, as long as the security agreement contemplates after-acquired property as collateral and the technical requirements of attachment are satisfied.<sup>150</sup> However, subsection 13(2) carves out two important exceptions to that rule. A security interest does not attach to after-acquired consumer goods unless the security interest is a PMSI or a security interest in property that replaces the original collateral. Similarly, a security interest does not attach to an after-acquired crop that starts to grow more than one year after the security agreement has been entered into, except where the security interest is given in conjunction with a lease, agreement for sale or mortgage of the land on which the crop is grown.

[235] Both exceptions were designed to protect presumptively vulnerable debtors from potential over-reaching on the part of creditors. The crops rule is intended to prevent a lender from claiming a security interest in crops grown by a farm debtor in successive years, thereby limiting the debtor’s ability to draw income from future crops and preventing them from using current crops as collateral for financing from other sources. The rule is based on a provision of UCC Article 9 that in turn originated in pre-Code depression era legislation and has since been removed.

[236] In practice, the rule offers little protection to farmers and only adds to the administrative cost and effort associated with a farm lending transaction. Lenders can circumvent the rule by including in the initial security agreement a provision under which the debtor undertakes to enter into new security agreements each year giving the lender a security interest in the crops grown in

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<sup>150</sup> PPSA, s 12(1) provides that a security interest attaches when value is given (by the secured party), the debtor has rights in the collateral and, for purposes of enforcement against third parties, the requirements of s 10 are satisfied. Subsection 13(1) makes it clear that a security interest automatically attaches to after-acquired property in accordance with s 12 without further action by either party.

that year. Debtors are induced to comply by the fact that refusal constitutes a default triggering the secured party's right to enforce against the current crop and other collateral. Compliance through the annual execution of a new agreement entails cost and inconvenience with no corresponding benefit. Furthermore, the chartered banks can avoid the rule entirely by taking *Bank Act* security on crops, since the *Bank Act* contains no similar limitation. The current rule therefore offers no meaningful benefit to debtors while imposing costs on debtors and creditors alike.

#### **RECOMMENDATION 28**

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The rules governing security interests in after-acquired property should not restrict attachment of an interest in after-acquired crops.

### **D. Subordination Agreements**

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[237] A secured party will sometimes voluntarily subordinate their security interest to the interest of another creditor to facilitate commercial arrangements that the subordinating creditor regards as beneficial. For example, a secured party who holds a first-ranking security interest in all present and after-acquired personal property of the debtor may agree to subordinate their interest to a subsequent lender, in whole or to a specified extent, to enable the debtor to obtain financing from another source. The objective is to reorder the priority of the security interests of the parties to the subordination agreement as it would otherwise be established by the PPSA priority rules. However, in some cases an agreement between secured parties may amount to a security agreement under which the subordinating creditor grants a security interest in their own interest to the benefiting creditor to secure the common debtor's obligation to the benefiting creditor. In other words, the effect of the agreement is not merely the reordering of the parties' respective security interests in the property of their shared debtor, but creation of a security interest in favour of the benefiting creditor, the property subject to that interest being the interest of the subordinating creditor. In such a case the benefiting creditor must perfect their security interest by registering against the subordinating creditor as debtor to secure priority over creditors or assignees of the subordinating creditor's interest.

[238] The parties to a subordination agreement generally intend to reorder the priority of their security interests, not to create a security interest in favour of the benefiting creditor. Several jurisdictions have included a provision in their PPSAs to ensure that a subordination agreement is not seen to create a security

interest, unless it is otherwise clear that the parties so intended. The Saskatchewan provision is as follows:

- 40(2) An agreement or undertaking to postpone or subordinate:
- (a) the right of a person to performance of all or any part of an obligation to the right of another person to the performance of all or any part of another obligation of the same debtor; or
  - (b) all or any part of the rights of a secured party pursuant to a security agreement to all or any part of the rights of another secured party pursuant to another security agreement with the same debtor;
- does not, by virtue of the postponement or subordination alone, create a security interest.

A provision to this effect avoids disputes over the effect of a subordination agreement and ensures that such an agreement does not produce an unanticipated result.

#### **RECOMMENDATION 29**

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The Act should include a provision to make it clear that a subordination agreement does not in itself create a security interest.

### **E. Notice of Enforcement**

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[239] The PPSA includes rules that govern the disposal of collateral by a secured party taking steps to enforce their security interest on default by the debtor. A secured party is not precluded from seizing and disposing of collateral to recover their claim by the fact that another creditor holds a higher ranking security interest in the property. However, the priority of the enforcing creditors' interest will determine the title of a person who purchases the collateral in an enforcement sale. A buyer acquires title free of the interest of the enforcing secured party and subordinate security interests, but subject to security interests that have priority over that of the enforcing secured party.<sup>151</sup>

[240] The notification rules in the Act reflect the rules that determine the buyer's title. An enforcing secured party is required to give notice of an intended disposition to a person with a security interest subordinate to that of the

<sup>151</sup> PPSA, s 62(7).

enforcing party if the subordinate interest is either registered or was perfected by possession at the time the collateral was seized. They are not required to give notice of the disposition to a secured party whose interest has priority.<sup>152</sup>

[241] The notice rules ensure that a person whose interest is subordinate and will be eliminated knows that a sale is pending. A subordinate secured party is entitled to redeem the collateral if they wish to do so by paying out the debt secured by the interest of the enforcing creditor, a course they may wish to take to preserve the debtor's business in the hope of recovering both the amount paid to redeem and their own claim.<sup>153</sup> Alternatively, they may wish to monitor the process of sale in the hope that the price obtained yields a surplus over the claim of the enforcing creditor, since surplus proceeds will be applied to a subordinate secured party's claim.<sup>154</sup>

[242] In theory, a secured creditor whose interest has priority and is not eliminated by the sale need not be notified, since their ability to enforce through seizure of the collateral is not affected; it may be seized in the hands of the buyer. However, the higher ranking secured party may be affected by the sale in other ways. For example, seizure and sale of the collateral may terminate the debtor's business and thereby eliminate the income stream through which a senior secured creditor expects to be paid. A subordinate secured creditor may seize as a tactical device to pressure a secured creditor who has priority to pay out the subordinate debt to avoid a threatened sale and ensure the debtor's continued viability. For those reasons, or others, a secured party with priority may wish to seek a stay of enforcement proceedings initiated by a subordinate creditor. A senior secured party should be given notice of proceedings taken by a subordinate party so they may take steps to protect their interest should they wish to do so.

[243] The Saskatchewan PPSA has been amended as recommended by the CCPSL to ensure that all secured parties, including those who hold a security interest with priority over that of an enforcing secured party, are entitled to receive a notice of disposition of the collateral. As in Saskatchewan, that result may be effected in Alberta by deleting the words "whose interest is subordinate to that of the secured party" from the notice rule in subsection 60(4)(b).

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<sup>152</sup> PPSA, s 60(4)(b).

<sup>153</sup> PPSA, s 63(1)(a).

<sup>154</sup> PPSA, s 61(1)(a).

**RECOMMENDATION 30**

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An enforcing secured party should be required to give notice of an intended disposition of collateral to all persons who hold a security interest in the property to be disposed of, regardless of whether their interest has priority over or is subordinate to the interest of the enforcing party.

## CHAPTER 9

# Civil Enforcement Act Amendments

## A. Introduction

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[244] The *Civil Enforcement Act* governs the recovery of judgments through the issuance, registration and enforcement of a writ of enforcement [a writ] against property of the judgment debtor. The Act includes rules that determine the priority of a writ binding personal property of a judgment debtor in relation to security interests and other interests. A writ binds when it is registered in the Personal Property Registry against the debtor's name. The CEA priority rules are clearly designed to reflect the priority structure of the PPSA. The priority of a registered writ is loosely comparable to the priority of a security interest perfected by registration.

[245] Amendment of the PPSA as proposed in this report will require amendment of the corresponding provisions of the CEA to maintain consistency as between the two statutes. Enactment of legislation to implement those amendments presents an opportunity to correct uncertainties and inconsistencies in the CEA priority rules at the same time. The recommendations proposed below would further harmonize the PPSA and CEA priority rules.

## B. Priority of a Writ Relative to a Security Interest in Personal Property

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[246] Section 35 of the CEA sets out the primary rules that govern the priority of a writ as against a security interest. The general priority rule implements a first-to-register approach that parallels the residual PPSA rule for competing security interests.<sup>155</sup> The PMSI rule also reflects the corresponding PPSA rule: a PMSI will have priority over a writ if steps are taken to perfect the security interest within a 15 day window.<sup>156</sup> However, the apparent goal of legislative coordination is undermined by the language of the CEA provisions, likely inadvertently.

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<sup>155</sup> CEA, s 35(1) provides that a registered writ has priority over a security interest. However, the rule is qualified by s 35(2), which provides that a security interest that is registered before a writ is registered has priority over the writ. Compare PPSA, s 35(1).

<sup>156</sup> Compare CEA, s 35(3) with PPSA, s 34(2).

[247] The general priority rule in subsection 35(2) gives a security interest priority over a writ if “at the time the writ is registered in the Personal Property Registry ... the security interest is perfected or registered in the Personal Property Registry”. The rule is clearly intended to give a perfected security interest priority over a registered writ based on the date of registration or the date of perfection by other means, but the structure of the provision is problematic.<sup>157</sup>

[248] Priority is established by subsection 35(2) if a security interest is registered or perfected *at the time the writ was registered* and is therefore not affected by a subsequent change in the registered or perfected status of the security interest. A security interest that becomes unperfected after the writ is registered through loss of registration or otherwise will maintain priority over the writ. This scenario illustrates the problem:

February 1: Bank obtains a security interest in all D’s present and after-acquired personal property and registers in the Personal Property Registry. The registration serves to perfect Bank’s interest.

March 1: Judgment Creditor obtains a judgment against D and registers a writ in the Personal Property Registry. The writ binds D’s present and after-acquired personal property.

April 1: Credit Union obtains a security interest in all D’s present and after-acquired personal property and registers in the Personal Property Registry. The registration serves to perfect Credit Union’s interest.

June 1: Bank’s registration is discharged in error or otherwise and is not re-registered.

[249] Under CEA subsection 35(2) as currently written, Bank’s security interest has priority over the writ so long as it remains attached, even if it becomes unperfected due to discharge of the registration. Bank’s interest was perfected “at the time the writ was registered” as required by the rule. Under the PPSA, in contrast, a security interest that becomes unperfected loses its priority as against a competing perfected security interest.<sup>158</sup> While Bank’s interest initially had priority over the security interest held by Credit Union, Credit Union’s interest

<sup>157</sup> The priority rule in CEA, s 35(2) is expressly “Subject to section 35(5) and (6) of the *Personal Property Security Act*,” governing the priority of future advances made by a secured party. PPSA, s 35(6) deals with priority as between a security interest and a writ of enforcement but s 35(5) addresses priority as between security interests. The reference to s 35(5) of the PPSA should therefore be deleted from CEA, s 35(2).

<sup>158</sup> This result is qualified by PPSA, s 35(8), discussed below.

would assume priority over Bank's interest when Bank's registration is discharged and its interest becomes unperfected.

[250] As a matter of policy, an unperfected security interest should not have priority over a registered writ and we doubt that this result was intended. Further, this inconsistency between the CEA and PPSA priority rules produces circular priority outcomes. After June 1, Bank has priority over Judgment Creditor, Judgment Creditor has priority over Credit Union, but Credit Union has priority over Bank.

[251] The problem is replicated in CEA subsection 35(3) with respect to the priority of a PMSI. A PMSI that was initially registered or perfected at the prescribed time will maintain priority over a registered writ even if the PMSI subsequently becomes unperfected through loss of registration or otherwise. Again, the result is inconsistent with the result produced by the corresponding PPSA rules governing priority as between security interests.

[252] The wording of these provisions also creates a conflict between the CEA priority rules and subsection 35(8) of the PPSA, which gives a secured party a limited opportunity to recover the priority status lost through lapse or discharge of the registration relating to their security interest. It provides in material part as follows:

35(8) If the secured party re-registers a security interest within 30 days after the lapse or discharge of its registration, the lapse or discharge does not affect the priority status of the security interest in relation to a competing perfected security interest *or registered writ of enforcement* that, immediately prior to the lapse or discharge, had a subordinate priority position (emphasis added).

[253] The PPSA rule clearly assumes that a writ registered after the security interest was initially registered is elevated over the security interest if the security interest is not re-registered within the 30 day period: re-registration is required to preserve the security interest's priority. Applied to our scenario, PPSA subsection 35(8) assumes that Judgment Creditor's writ acquires priority over Bank's security interest as at June 1 *unless* Bank re-registers within 30 days. However, this assumption is contradicted by the wording of the CEA priority rules just discussed. Under the CEA rules, Bank's security interest never loses priority as against the writ when registration is lost so the secured party need not re-register within the 30 day period prescribed by the PPSA rule in order to maintain pre-discharge priority.

[254] Finally, the fact that an unperfected security interest may have priority over a registered writ creates a potential problem for enforcing writ holders. A buyer of personal property in proceedings to enforce the writ takes free of security interests subordinate to the writ but subject to interests that have priority.<sup>159</sup> However, a search of the registry will not disclose an unperfected security interest that may have priority over the writ being enforced. A judgment creditor should be able to rely on the registry in determining whether to initiate enforcement measures.<sup>160</sup>

[255] These problems could be remedied by amending the priority rules in CEA subsections 35(2) and (3) to provide that a “perfected” security interest has priority over a writ in the circumstances specified. A security interest that loses perfected status through loss of registration or otherwise could no longer claim the benefit of a priority rule. In our scenario, the writ would have priority over Bank’s security interest as at June 1, unless Bank re-registers within the 30 day period offered by PPSA subsection 35(8).

***Key Element***

A security interest that has priority over a writ on the basis of time of registration or perfection should have priority only if perfected.

## **C. Time for Determining Priorities**

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[256] Previously in this report we consider the need for an explicit rule to establish whether priority between security interests is determined at the time enforcement action is taken by a secured party or at the time the collateral is transferred to a buyer in enforcement proceedings.<sup>161</sup> We recommend that uncertainty in that regard be resolved through a PPSA provision stating that the priority of a security interest in relation to another security interest is not affected by enforcement measures taken by the other secured party.<sup>162</sup> In effect, this means that priority is determined at the time collateral is transferred to a buyer and may change after enforcement is initiated as a result of changes in the registry.

<sup>159</sup> CEA, ss 34(2), 48(j).

<sup>160</sup> A regular search will only disclose active registrations. A distribution seizure search will disclose registrations that are no longer active, but is limited to registrations that existed within 21 days of the search date and is available only to civil enforcement agencies.

<sup>161</sup> See Chapter 5 heading C. Time for Determining Priorities.

<sup>162</sup> See Recommendation 20.

[257] The problem addressed by the recommendation may also arise in a competition between a security interest in personal property and a binding writ. If enforcement proceedings are commenced by either the secured party or the writ holder, does priority change if the registration relating to the security interest or the writ lapses or is discharged before the property is sold?

[258] The reasons for our recommendation regarding the PPSA rule apply equally to a priority competition between a registered writ and a security interest in personal property.<sup>163</sup>

**Key Element**

The priority of a security interest in personal property in relation to a writ of enforcement should not be affected by enforcement measures taken by either the secured party or the writ holder.

## **D. Priority of Buyers and Lessees**

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[259] The CEA provides priority rules to protect people who buy or lease goods bound by a writ.<sup>164</sup> These are often referred to in short as the “buyer protection” rules and, for the sake of simplicity, we generally refer under the headings that follow to the priority of a buyer in relation to a writ. However, the discussion applies equally to a lessee unless the context indicates otherwise.

[260] The CEA rules reflect the PPSA rules protecting buyers from a security interest in goods, though they differ on points of detail discussed below.<sup>165</sup> The CEA adopts the PPSA provision defining “buyer of goods” by reference,<sup>166</sup> and replicates the PPSA provision that specifies the consideration that may be given under a sale or lease for purposes of these rules.<sup>167</sup> Harmonization of the CEA and PPSA provisions that condition the operation of the priority rules is important and should be preserved. The recommendation advanced earlier in this report with respect to the effect of a title reservation clause in a contract of sale should accordingly be extended to the CEA.

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<sup>163</sup> See Chapter 5 heading C.

<sup>164</sup> CEA, s 36.

<sup>165</sup> PPSA, s 30. In addition, s 20 applies to a buyer or lessee of goods subject to an unperfected security interest.

<sup>166</sup> CEA, s 31(b)(i).

<sup>167</sup> PPSA, s 30(8), CEA, s 36(4).

**Key Element**

The CEA should incorporate by reference or replication the PPSA provision that would be added under Recommendation 16 with respect to the effect of a title reservation clause in a contract of sale.

## **E. Priority of Buyers and Lessees of Consumer Goods**

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[261] CEA subsection 36(3) corresponds with PPSA subsections 30(3) and (4). A buyer or lessee of consumer goods worth \$1,000 or less takes free of a binding writ or a security interest in the goods, provided they take without knowledge.

[262] Earlier in this report we recommend that the PPSA rule be revised in two respects. First, we recommend that a buyer of low value consumer goods take free of a security interest in the goods whether or not they have knowledge of the security interest. The reasons supporting that recommendation also apply in a competition between a buyer and a registered writ.<sup>168</sup> Further, consistency between the PPSA and CEA rules is required to avoid the potential for circular priority outcomes.<sup>169</sup> The same conditions of priority should apply under both statutes.

**Key Element**

A buyer or lessee of low-value consumer goods should have priority over a writ binding the goods whether or not they have knowledge of the writ.

[263] Second, we recommend that the monetary limit in the PPSA rule be increased to \$1,500 or such other amount as may be permitted by regulation.<sup>170</sup> The CEA rule should be amended to the same effect.

**Key Element**

The monetary limit that applies to the *Civil Enforcement Act* priority rule governing low-value sales and leases of consumer goods should be increased from \$1,000 to \$1,500 or such other amount as may be prescribed by regulation.

<sup>168</sup> See Chapter 4 heading B2: The Relevance of Knowledge.

<sup>169</sup> Assume SP has a security interest in D's \$500 bike perfected by a registration effected on May 1. Judgment Creditor (JC) has a writ registered against D on June 1. On July 1 D sells the bike to B, who has knowledge of both the security interest and the writ. If the PPSA rule is amended but the CEA rule is not, SP would have priority over JC, JC would have priority over B and B would have priority over SP.

<sup>170</sup> See Recommendation 15.

## F. Priority Rules for Serial Number Goods

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[264] The CEA adopts the PPSA definition of “serial number goods”<sup>171</sup> and, like the PPSA, provides special priority rule rules for interests in such goods. However, the CEA departs from the PPSA approach in significant respects.

### 1. BUYERS AND LESSEES OF SERIAL NUMBER CONSUMER GOODS AND EQUIPMENT

[265] Under the PPSA, a buyer of serial number goods held either as consumer goods or equipment has priority over a security interest in the goods if the security interest is not perfected by a registration that includes the serial number of the goods and the buyer takes without knowledge of the security interest. The result is the same with respect to both types of goods but the reasons for that result differ. In the case of serial number equipment, a priority rule addressed specifically to buyers applies: a buyer without knowledge takes free of a security interest perfected by registration if the registration does not include the serial number of the goods.<sup>172</sup> In the case of consumer goods, the failure to register by serial number means that the security interest is unperfected<sup>173</sup> and, under the general priority rule of section 20, an unperfected security interest is subordinate to the interest of a buyer if the buyer takes without knowledge.<sup>174</sup> Both approaches are designed to protect a buyer who might search the registry by serial number. The buyer should be protected if the registry search does not disclose a security interest in the goods provided they do not otherwise have knowledge of the security interest.<sup>175</sup>

[266] The CEA applies the same approach to buyers of serial number goods held as equipment: a buyer of equipment has priority over a registered writ if the registration does not include the serial number of the goods and the buyer takes without knowledge of the writ.<sup>176</sup> However, a different rule applies to consumer

<sup>171</sup> CEA, s 1(1)(qq).

<sup>172</sup> PPSA, ss 30(6) and (7).

<sup>173</sup> Regulation, s 34(1)(a). Registration by serial number is optional to perfect with respect to serial number goods held as equipment: Regulation, s 34(1)(b). We recommend earlier in this report that registration of serial numbers with respect to serial number goods held as consumer goods should similarly be optional rather than mandatory to perfect a security interest. However, consumer goods would also be brought within the rule under which a buyer would have priority over a security interest perfected by a registration that does not include the serial number.

<sup>174</sup> PPSA, s 20(b).

<sup>175</sup> Recommendation 14 would eliminate the requirement that the buyer take without knowledge of the security interest to have priority.

<sup>176</sup> CEA, s 36(3)(b).

goods. A buyer takes priority over a writ that is not registered by serial number even if the buyer knows of the writ.<sup>177</sup> We suspect that this discrepancy was inadvertent. The drafters of the CEA rules may have overlooked the result that follows under the PPSA from failure to include the serial number in a registration relating to a security interest in serial number consumer goods. There is no policy reason to differentiate between consumer goods and equipment in this respect. The conditions under which a buyer has priority over a writ binding serial number goods should be the same whether the goods are held as serial number goods or equipment.

## 2. PRIORITY OF A SECURITY INTEREST IN SERIAL NUMBER GOODS

[267] The CEA rules that determine the priority of a buyer of serial number goods as against a writ binding the goods apply in the same terms to the priority of a security interest. They provide in material part that “a buyer, lessee *or secured party* who gives value for an interest in the goods ... acquires the interest free of the writ (emphasis added)”. Therefore the discrepancy in the rules that apply to buyers of serial number consumer goods and equipment similarly extends to a priority competition between a registered writ and a security interest that arises after the writ is registered. In the case of consumer goods, a secured party has priority over a writ that is not registered by serial number even if the secured party knows of the writ. If the collateral is equipment, the secured party has priority if only if they acquire their interest without knowledge of the writ. Under the PPSA, in contrast, the same conditions of priority apply to security interests in both types of serial number goods, and knowledge of a competing security interest on the part of a secured party is not a factor in either context.<sup>178</sup> The inconsistent approach in the CEA rules should be corrected.

[268] The CEA priority rules for security interests in serial number consumer goods and equipment are problematic for another reason. A registered writ binding such goods is subordinate to a security interest in the goods if the registration of the writ does not include the serial number of the goods,

<sup>177</sup> CEA, s 36(3)(a).

<sup>178</sup> An unperfected security interest is subordinate to a perfected security interest (PPSA s 35(1)). A security interest in serial number consumer goods is perfected by registration only if the registration includes the serial number of the goods (Regulation s 34(1)(a)). Although registration by serial number is optional to perfect a security interest in serial number equipment (Regulation s 34(1)(b)), a security interest perfected without serial number is treated as unperfected for purposes of a priority competition with another security interest (PPSA s 35(4)). Earlier in this report we recommend that the rules that apply to equipment apply equally to consumer goods. See Recommendation 22. However, this would not change the outcome in a priority dispute between security interests in either type of goods.

regardless of whether the security interest is perfected. Under the corresponding PPSA rules, a security interest that is not registered by serial number is subordinate to a subsequent security interest only if the subsequent interest is perfected. An unperfected security interest may therefore have priority over a registered writ binding serial number goods although it does not have priority over a competing security interest in the goods. As a matter of policy, there is no reason to give an unperfected security interest priority over a registered writ or to differentiate between the PPSA and the CEA in this respect. A secured party who wishes to establish priority over competing claims will typically take steps to perfect their security interest and can easily do so.

[269] The fact that an unperfected security interest may have priority over a writ binding serial number goods also raises the enforcement problem previously noted in relation to the general priority rules. A judgment creditor who searches the registry will not discover the security interest and may initiate enforcement action on the assumption that the goods in question are not subject to a higher ranking claim.

### 3. DIFFERENTIATING BUYERS FROM SECURED PARTIES

[270] Under the PPSA, the provisions that govern the priority of a buyer of serial number goods as against a security interest in the goods are different from those that govern the priority of competing security interests. As we have seen, the CEA deals with the priority of buyers and secured parties in provisions that apply equally to both. The CEA approach is structurally anomalous and creates problems in the operation of the rules as they apply to security interests.

[271] The other priority rules of the PPSA and the CEA speak to the priority of a competing claim over a security interest, not over the holder of the interest - ie the secured party. That usage reflects two related facts. It is the security interest, not the person who holds it, that has a priority ranking as against a competing security interest or a writ in the same property. The language of the CEA rules is anomalous in that it ranks an *in rem* claim (the writ) against a person (a secured party), rather than against a competing claim (a security interest). Further, a security interest should be accorded priority over a writ or another interest only to a limited extent - ie to the extent of the debt it secures. The conferral of priority on a "secured party" suggests that the secured party has priority over a writ regardless of the amount of the debt secured by their interest.

[272] The CEA rule is also problematic in that it states that a secured party “takes free of” a writ. While this language is appropriate for a buyer, who acquires the debtor’s entire interest, it is not appropriate for a secured party, whose interest is limited. Any value in the goods in excess of the amount required to retire a security interest that has priority over a writ should be applied to the writ. However, the statement that the secured party “takes free” may be read to suggest that the writ is eliminated when the security interest arises, as it is when a buyer “takes free”. These anomalies should be addressed in revised provisions.

#### 4. RATIONALIZATION OF PPSA AND CEA PRIORITY RULES FOR SERIAL NUMBER GOODS

[273] The following amendments would address the concerns identified with respect to the priority rules governing serial number goods.<sup>179</sup>

***Key Element***

The CEA priority rules that apply to serial number consumer goods and equipment should be consistent with the corresponding rules of the PPSA in the following respects:

- The rules that determine the priority of a security interest as against a writ binding serial number goods held as consumer goods or equipment should be separate from those that determine the priority of a buyer or lessee of such goods and should be addressed to the priority of a “security interest” rather than a “secured party”.
- A writ binding serial number goods held as consumer goods or equipment should be subordinate to a subsequent security interest if the goods are not described by serial number in the registration of the writ and the security interest is perfected. Knowledge of the writ on the part of the secured party should not be a factor in determining priority.
- A buyer or lessee of serial number goods held as consumer goods or equipment should take free of a writ binding the goods if the goods are not described by serial number in the registration of the writ.

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<sup>179</sup> Correspondence with the current PPSA rule would require that the buyer also take without knowledge of the writ. As previously noted, we recommend that the lack-of-knowledge requirement be deleted from the PPSA rule for buyers of serial number goods and applied equally to equipment and consumer goods. The CEA rule should adopt the same approach.

## G. Negotiable Property

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[274] We discuss the PPSA priority rules that apply to negotiable property earlier in this report and recommend that they be revised to reflect current market practices, including the transfer of funds by electronic means.<sup>180</sup> The corresponding rules of the CEA should be similarly amended to maintain consistency of treatment with respect to this type of property.<sup>181</sup>

[275] The amendment of these rules also creates an opportunity to consider the only material discrepancy that currently exists in this context between the PPSA and the CEA. The CEA does not include a rule that protects a person who receives payment of a debt by means of an instrument drawn in their favour by the debtor if the person paid has knowledge of a writ registered against the debtor. Under the PPSA, a person who receives such a payment has priority over a security interest in the instrument regardless of whether they have knowledge of the security interest.

[276] The PPSA priority rules are designed to ensure that security interests in payment instruments and mechanisms do not interfere with routine commercial activity.<sup>182</sup> These considerations apply equally under the CEA. As we note in our discussion of the PPSA rules, the priority results that follow from a transfer of negotiable property should be the same regardless of the mechanism by which the transfer is effected. A creditor who receives payment of a debt in physical currency has priority over a writ binding the money regardless of whether they have knowledge of the writ. There is no relevant difference between a payment made in cash and one made by cheque (or another instrument). Further, adoption of the PPSA approach to debtor-initiated payments would avoid the potential circular priorities that may result under the current rules. A security interest in an instrument that has priority over a writ binding the instrument under the CEA priority rules will be subordinated by the PPSA to the interest of a creditor who receives the instrument in payment of a debt, while the writ will have priority over the creditor if the creditor has knowledge of the writ.

[277] The CEA should also include a rule corresponding to the PPSA rule that would restrict the ability of a deposit-taking institution that receives payment of

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<sup>180</sup> See Chapter 4 heading A. Payment of Debts and Transfers of Negotiable Property.

<sup>181</sup> CEA, ss 38(1)-(4). Compare PPSA, ss 31(1)-(5).

<sup>182</sup> See Cuming, Walsh & Wood, note 42 at 408.

a debt from the debtor to claim priority over a prior interest in the instrument or funds taken in payment.

**Key Element**

The rules that determine the priority of a writ binding negotiable property as against a transferee should parallel those that determine the priority of a security interest.

## H. Securities

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[278] The *Securities Transfer Act* [STA] introduced a new system of law governing transactions involving securities and other financial assets. The STA was accompanied by amendments to the PPSA and CEA designed to create a proper interface among the three statutes. The amendments enacted a system of priority rules exclusive to this form of property but, in the case of the CEA, two points of detail appear to have been overlooked and should be addressed. The provisions in question are subsection 35(3) and section 38.

[279] The CEA amendments deleted the rules that previously applied to market securities and enacted a new rule in section 39, which applies to securities generally, both certificated and uncertificated.<sup>183</sup> However, the pre-existing wording of section 38, which applies to writs binding negotiable property, was not amended to remove certificated securities from the ambit of that provision. The result is two slightly different rules for certificated securities. Under the section 38 rule, a purchaser will have priority over a writ binding a security certificate (the physical embodiment of a certificated security) if they give value, take without knowledge of the writ and take possession of the certificate. Under the new rule in section 39, a purchaser will have priority over a writ binding a security only if they are a protected purchaser under the STA. A person is a protected purchaser if they do not have knowledge of any “adverse claim”, as defined by the Act, and have obtained control.<sup>184</sup> Control with respect to a certificated security in bearer form is established by delivery alone. In the case of a certificated security in registered form, endorsement or registration of the security certificate is also required.<sup>185</sup>

[280] The result of this discrepancy is that in certain circumstances a purchaser of a certificated security who cannot claim priority over a writ under section 39

<sup>183</sup> CEA, s 38(3) was repealed and s 39 replaced with a new rule.

<sup>184</sup> STA, s 1(1)(a).

<sup>185</sup> STA, ss 23 and 24.

can claim priority under section 38. A purchaser who obtains delivery through possession of a certificated security in registered form but does not have control can claim priority over a writ under section 38 if they take without knowledge, but cannot claim priority under section 39 because they do not qualify as a protected purchaser. Similarly, a purchaser who does not have knowledge of the writ but does know of another adverse claim against the security is not a protected purchaser so cannot claim priority over the writ under section 39, but could claim priority under section 38.

[281] The section 38 rule that allows a purchaser of a certificated security who does not have control to take priority over a writ is anomalous in comparison with both section 39 and with the corresponding priority rules of the PPSA. Before the STA was enacted, the PPSA priority rule for security interests in instruments also applied to securities. The reference to securities was deleted by the STA amendments and new rules enacted under which priority as between competing claims is based primarily on control. A perfected security interest will generally be defeated only by the claim of a person who has obtained control.<sup>186</sup>

[282] Further, the existence of different CEA rules addressing the same form of property is confusing. Amended provisions dealing with competing claims to negotiable property should therefore not apply to security certificates, which should be subject to the rule that applies to securities generally. Adoption of the amendment proposed under the immediately preceding section of this report would achieve that result, since the corresponding PPSA rules do not apply to securities. However, we discuss securities separately to make it clear that they should be addressed under the section 39 rule and not under the rules for negotiable property.

[283] A similarly redundant reference to certificated securities appears in section 35(3)(b), which deals with the priority of a PMSI. The CEA adopts the PPSA definition of PMSI by reference.<sup>187</sup> That definition defines a PMSI as a security interest in collateral “other than investment property” to secure purchase-money obligations.<sup>188</sup> The PPSA definition of investment property includes “a security, whether certificated or uncertificated.” This means that a creditor cannot claim a PMSI in a security under the PPSA, with the associated

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<sup>186</sup> See Cuming, Walsh and Wood, note 42 at 413–15 and see PPSA, ss 30(9), 31.1 and 35.1. In the case of competing security interests perfected by registration, priority is determined by the residual first-to-register rule of PPSA, s 35. However, a security interest perfected by control has priority over an interest perfected by registration. See PPSA, s 35.1.

<sup>187</sup> CEA, s 31(b)(ix).

<sup>188</sup> PPSA, s 1(1)(II).

potential for PMSI priority. However, the CEA version of the PMSI rule applies by its terms to a PMSI in a security certificate – in other words, in a certificated security. The result is a CEA priority rule that is inconsistent with the PPSA definition of PMSI adopted in the CEA, and inconsistent with the PPSA priority rule for PMSIs. The reference to a security certificate in CEA clause 35(3)(b) should be deleted.

**Key Element**

The CEA priority rules that apply to PMSIs and negotiable property should not apply to security certificates.

## I. Electronic Chattel Paper

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[284] The CEA includes a rule under which a purchaser of chattel paper may have priority over a writ. The CEA rule reflects the corresponding provisions of the PPSA.<sup>189</sup> A purchaser of chattel paper (including a secured party) has priority over a writ if the purchaser gave new value and took possession of the chattel paper in the ordinary course of business without knowledge of the writ.

[285] We recommend earlier in this report that the PPSA be amended to differentiate between tangible and electronic chattel paper and to provide specialized rules for the latter.<sup>190</sup> The CEA should similarly address electronic chattel paper and tangible chattel paper as distinct forms of property.

[286] The recommended PPSA priority rule for security interests in chattel paper abandons knowledge of a prior security interest on the part of a purchaser as a factor in determining the purchaser's priority. A purchaser of chattel paper will have priority over a security interest if (i) the purchaser takes possession of tangible chattel paper or obtains control of electronic chattel paper, (ii) the purchaser acquires their interest in the ordinary course of their business and for new value and (iii) the chattel paper does not indicate that it has been assigned to the competing secured party or another person. The third element of the test cannot be extended to priority competitions involving a writ, since chattel paper will never be marked or stamped with notice of a writ. The CEA priority rule should therefore follow the PPSA with respect to the first two conditions of

<sup>189</sup> CEA, s 38(5), PPSA s 31(6). The PPSA rule differentiates a security interest that attaches to chattel paper as proceeds of inventory from one that attaches to chattel paper as original collateral. The CEA does not provide separate rules for proceeds property in any context, since a writ binds all property of a debtor once registered.

<sup>190</sup> See Chapter 7.

priority but retain as the third condition the existing requirement that the purchaser did not have knowledge of the writ.<sup>191</sup>

***Key Element***

Chattel paper should encompass both tangible chattel paper and electronic chattel paper. The definitions of these types of property should parallel the definitions included in the *Personal Property Security Act*.

A purchaser of chattel paper should have priority over a writ binding the chattel paper if the purchaser (i) acquires their interest in the ordinary course of their business and for new value, (ii) takes possession of tangible chattel paper or obtains control of electronic chattel paper and (iii) at the time of taking possession or obtaining control did not have knowledge of the writ.

References to chattel paper that appear elsewhere the Act should be amended as required to specify chattel paper, tangible chattel paper or electronic chattel paper, as may be appropriate to the context.

## **J. Harmonization of PPSA and CEA Priority Rules**

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[287] The PPSA and the CEA are complementary statutes dealing respectively with the rights of creditors who hold security interests in personal property and the rights of creditors who hold registered writs, both of which entail rights of enforcement against property to recover a debt. Both Acts implement priority rules based primarily on registration of creditors' claims in the Personal Property Registry. Consistency in these rules is important both to ensure compatible policy outcomes and to facilitate clarity and certainty in the law governing creditors' rights.<sup>192</sup> The amendments proposed in this chapter are designed to advance that goal by further harmonizing the CEA priority rules for personal property with those of the PPSA.

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<sup>191</sup> It is not necessary to amend the residual CEA priority rule that applies as between writs and security interests. A security interest in electronic chattel paper that is perfected either by control or by registration at the time a writ is registered will have priority over the writ. If it is not perfected by either means, the writ will have priority.

<sup>192</sup> The point is reflected in the reformed judgment enforcement law of Saskatchewan. The *Enforcement of Money Judgments Act*, SS 2010, c E-9.22, s 23 applies the SPPSA priority rules to a charge created by registration of a judgment by reference. Subject to certain exceptions, an enforcement charge has the same priority in relation to other interests in the property charged as a perfected security interest, other than a PMSI.

**RECOMMENDATION 31**

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The PPSA and CEA priority rules should be harmonized by amending the CEA to provide that a writ registered in the Personal Property Registry is generally afforded the same priority status with respect to personal property as a security interest perfected by registration.



Deadline for comments on the issues raised in  
this document is **March 1, 2021.**



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