Court File No. CV-14-10766-00CL

*ONTARIO*
**SUPERIOR COURT OF JUSTICE**
**(COMMERCIAL LIST)**

BETWEEN:

TRISURA GUARANTEE INSURANCE COMPANY

Applicant

- and -

EBERSOLE EXCAVATING INC. AND D&S RAILWAY CONSTRUCTION INC.

Respondents

IN THE MATTER OF AN APPLICATION PURSUANT TO SECTION 47 OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, c. B-3, AS AMENDED; AND SECTION 101 OF THE *COURTS OF JUSTICE ACT*, R.S.O. 1990, c. C.43, AS AMENDED

AND IN THE MATTER OF SECTION 243(1) OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, c. B-3, AS AMENDED; AND SECTION 101 OF THE *COURTS OF JUSTICE ACT*, R.S.O. 1990, c. C.43, AS AMENDED

# BOOK OF AUTHORITIES OF MAYNARDS INDUSTRIES LTD.
**(Distribution Hearing Returnable May 13, 2015)**

May 7, 2015

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## LIST OF AUTHORITIES

1. McLaren, Richard H., *Transactions in Personal Property* (3rd edition) (Toronto: Thomson Reuters), pages 7-221 to 7-223

2. *Concentra Financial Services Assn v. Kille* (2008) 43 C.B.R. (5th) 245

3. *CIBC v. CTV Television Inc.* (2005) 18 C.B.R. (5th) 217

4. The 2015 Annotated Ontario Personal Property Security Act, Professor Richard H. McLaren, Thomson Reuters, 2015 – Commentary re: Section 28(5)

5. *Bank of Nova Scotia v. IPS Invoice Payment System Corporation* 2010 ONSC 2101 (Ont. Sup. Ct.)

6. *H&R Block Canada Inc. v. National Trust Co.* 2003 SCC 66

7. *GE Canada Equipment Financing G.P. v. ING Insurance Co. of Canada,* 2009 ONCA 171

# TAB 1

**[e] Non-negotiable Documents**

Non-negotiable documents are not included in the list of classes of collateral set out in s. 22,[799] but are within the provision of s. 23[800] permitting perfection by registration. The Act does not state a rule of priority for Non-negotiable documents of title. The explanation for the failure to state a rule is that, under the Act, a security interest in goods covered by a non-negotiable document is considered to be in the goods themselves and not in the document as their symbolic representative. This treatment becomes evident by contrasting the provisions for bailee-held goods in ss. 26(1) and 26(2).[801] Under s. 26(1), it is very clear that the interest of a bailee who has issued a negotiable document of title is not in the goods but in the document so issued. By contrast, s. 26(2), which applies, by deduction, to goods which are covered by a non-negotiable document of title, provides several methods of perfection of a security interest in the goods themselves. Unauthorized dispositions of non-possessory interests in goods covered by a non-negotiable document will, therefore, be dealt with as dispositions of goods.

**[f] Dispositions of motor vehicles: s. 28(5)**

Section 28(5) applies to dispositions of motor vehicles that are equipment to the seller, where the sale is not in the ordinary course of business.[802] If the secured party has registered the vehicle identification number of the motor vehicle collateral, the secured party's perfection and priority is maintained and the prospective purchaser has the means to ascertain whether the vehicle is subject to a security interest. If the secured party has not registered the vehicle identification number of the motor vehicle collateral, the purchaser takes priority unless the purchaser knew that the sale constituted a breach of the security agreement.

When a used vehicle is sold by private sale in Ontario, a seller must give a used vehicle information package to the buyer. This is the result of the addition of s. 43.1 to the Act and s. 11.1 to the *Highway Traffic Act*.[803] The used vehicle information package represents a consolidation of

**799** See s. 24 Alta. Act, B.C. Act, Man. Act, N.B. Act, Nun. Act, 24 N.W.T Act, P.E.I. Act, Sask. Act; s. 25 Nfld. Act, N.S. Act; s. 22 Yuk. Act.

**800** See s. 25 Alta. Act, B.C. Act, Man. Act, N.B. Act, Nun. Act, N.W.T Act, P.E.I. Act, Sask. Act; s. 26 Nfld. Act, N.S. Act; s. 23 Yuk. Act.

**801** See s. 27 Alta. Act, Man. Act, N.B. Act, Nun. Act, N.W.T Act, P.E.I. Act, Sask. Act, Yuk. Act; s. 28 B.C. Act, Nfld. Act, N.S. Act.

**802** In ***Royal Bank v. Bank of Nova Scotia***, 1994 CarswellOnt 768, 6 P.P.S.A.C. (2d) 250 (Ont. Gen. Div. [Commercial List]) at para. 19 the court found that the sale was in the ordinary course of business and thus did not need to consider s. 28(5).

**803** R.S.O. 1990, c. H.8.

important information relating to the vehicle, including the vehicle's registration and lien history, as well as information regarding retail sales tax. Thus the buyer will be able to determine if the vehicle is from a rental or taxi fleet and if there are secured transactions under the Act affecting the vehicle. The buyer has six days from the date of purchase to present the used vehicle information package to a Ministry of Transportation Driver and Vehicle Licence Issuing Office. This also ensures sales tax is collected.

The other Acts contain similar provisions with respect to dispositions of equipment goods that are defined as serial numbered goods by the regulations. For example, ss. 30(6) and 30(7)[804] of the Alberta Act provide that a buyer or lessee of equipment will take free from security interests that were perfected by registration provided that the buyer or lessee was without knowledge of the security interest and that the goods were not described by serial number in the registration even though they were serial number goods.[805] These provisions protect detrimental reliance by buyers who give new value against equipment after having conducted a serial number search that does not disclose a security interest in the equipment. They also create a strong incentive for parties with interests in serial numbered equipment goods to perfect their security interests by registering a financing statement which describes the collateral by serial number.[806] The incentive to register by serial number is enhanced by s. 35(4)[807] of the Alberta Act which provides that if the security interest is not described by serial number, it will be subordinated to the interest of a secured party that has registered by serial number.[808]

By exclusion, the buyer or lessee of serial number equipment goods, which were correctly described by serial number in a registration, would not take the goods free of the security interest perfected by registration. However, if the serial number is incorrectly registered, and the buyer conducts a search using the correct serial number, then the buyer takes the goods free of security as long as the buyer did not have knowledge of

**804** See ss. 30(6) and (7) B.C. Act, N.B. Act, Nun. Act, N.W.T. Act, P.E.I. Act, Sask. Act; ss. 31(6) and (7) Nfld. Act, N.S. Act; s. 30(6) Man. Act; s. 29(2) Yuk. Act.

**805** For example, see ***Concentra Financial Services Assn. v. Kille***, 2008 CarswellSask 50, 43 C.B.R. (5th) 245 (Sask. Q.B.).

**806** See ***Canadian Imperial Bank of Commerce v. CTV Television Inc.***, 2005 CarswellNB 776, 9 P.P.S.A.C. (3d) 78 (N.B. Q.B.).

**807** See also s. 35(4) B.C. Act, Man. Act, N.B. Act, N.S. Act, Nun. Act, N.W.T. Act, P.E.I. Act, Sask. Act; s. 36(4) N.L. Act.

**808** See ***Business Development Bank of Canada v. Finder Bueckert & Associates Inc.***, 2009 CarswellSask 776, 16 P.P.S.A.C. (3d) 52, (Sask. Q.B.) at para. 43.

the security interest. The buyer has no duty to conduct an additional search in the debtor's name.[809]

In ***Sleeping Giant Investments Inc. v. Southey Farm Supply Ltd.***,[810] a buyer sought to apply s. 30(6) of the revised Sask. Act against a secured party who had properly registered its interest in a tractor under the prior Sask. Act, without including its serial number. However, under ss. 2(1)(o) and 2(1)(u) of the revised Act's regulations a tractor is included as a "motor vehicle" and accordingly as a "serial numbered good", thus requiring registration by serial number under the revised Act. The secured party did not re-register its interest by serial number and the buyer claimed priority under s. 30(6) of the revised Act. The court held that the transition provision of s. 74(2) maintained the priority status of the secured party despite the operation of s. 30(6) and the failure to re-register by serial number. The court stated that it would be unreasonable that general security agreements arising before the revised Sask. Act came into force would lose their efficacy against serial numbered goods by virtue of s. 30(6) without allowing a grace period in which to amend the registration to include serial numbers. This grace period is provided by s. 74(2) and therefore the secured party maintains its priority over the buyer.

## §7.06 PRIORITY RULES IN THE CONTEXT OF BANKRUPTCY

### *[1] PERFECTED INTERESTS IN THE CONTEXT OF BANKRUPTCY*

#### [a] Time When Priority Arises

In a bankruptcy situation, the date for determination of priorities is straightforward: it is the date of the bankruptcy as defined in s. 2 of the *Bankruptcy and Insolvency Act*.[811] For a voluntary assignment into bankruptcy, this is the date and time upon which the debtor files the assignment into bankruptcy. For an involuntary bankruptcy, it is the date upon which the court grants a bankruptcy order against the person, or the date and time of any event which causes the debtor to be deemed to have been assigned into bankruptcy, because this is the time at which the rights of creditors come into conflict, and not the date on which the creditor files the petition. These principles are partially enshrined in s. 20(2)[812] of the Act for statutory liens, but have been more clearly delineated by the case law. For example, in ***Royal Bank v. Anderson***

**809** See ***Harry Watson Farm Supply Ltd. v. Hi-Way Service Inc.***, 2000 CarswellAlta 1185, 258 A.R. 330 (Alta. Master).

**810** 1996 CarswellSask 110, 11 P.P.S.A.C. (2d) 128 (Sask. Q.B.), affirmed 1997 CarswellSask 482, 13 P.P.S.A.C. (2d) 1 (Sask. C.A.).

**811** *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, s. 2. See also ss. 42-43.

**812** The other provinces and territories do not have a similar section.

# SECURED TRANSACTIONS IN PERSONAL PROPERTY IN CANADA

## THIRD EDITION

by

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## VOLUME 2

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# TAB 2

2008 SKQB 42
Saskatchewan Court of Queen's Bench

Concentra Financial Services Assn. v. Kille

2008 CarswellSask 50, 2008 SKQB 42, 43 C.B.R. (5th) 245

# Concentra Financial Services Association (Applicant) and Albina Kille (Respondent)

R.C. Mills J.

Judgment: January 28, 2008
Docket: Saskatoon Q.B.G. 1303/07

Counsel: W.R. Rooke, Q.C. for Applicant, Concentra Financial Services Association
G.S. Wyant for Respondent, Albina Kille

Subject: Corporate and Commercial; Insolvency

**Related Abridgment Classifications**
For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

**Headnote**

**Personal property security --- Priority of security interest — Effect of notice or knowledge**

Applicant C Ass. had perfected security interest in buses owned by H Ltd. — H Ltd. sold buses to respondent employee K who entered into extended year lease agreement with H Ltd. for use of buses — K did not register her lease with Personal Property Registry, nor did she search H Ltd.'s name in registry when she made purchase — H Ltd. went bankrupt, and two buses were sold and proceeds held in trust, and third bus was being used under lease agreement with K — C Ass. brought application under Personal Property Security Act making claim on buses and for unpaid purchase price of buses and for fair market value rent of one bus still in K's possession — Application granted in part — K obtained title to buses clear of any claim from C Ass., as she came within provisions of s. 30(6) of Act — K was not aware of security interest of C Ass., and buses were not described by serial number in C Ass.' registration — However, C Ass. had valid prior claim enforceable ahead of K's lease — K's primary source of income as employee of H Ltd. was complemented by her leasing business as she would have more immediate knowledge of use of her buses and financial stability of company — Leasing of buses was significant operation — K was regularly engaged in business of leasing within meaning of s. 2(1)(y)(iv) of Act, and thus was not entitled to exemption from registration.

**Personal property security --- Perfection of security interest — Miscellaneous**

Applicant C Ass. had perfected security interest in buses owned by H Ltd. — H Ltd. sold buses to respondent employee K who entered into extended year lease agreement with H Ltd. for use of buses — K did not register her lease with Personal Property Registry, nor did she search H Ltd.'s name in registry when she made purchase — H Ltd. went bankrupt, and two buses were sold and proceeds held in trust, and third bus was being used under lease agreement with K — C Ass. brought application under Personal Property Security Act making claim on buses and for unpaid purchase price of buses and for fair market value rent of one bus still in K's possession — Application granted in part — K obtained title to buses clear of any claim from C Ass., as she came within provisions of s. 30(6) of Act — K was not aware of security interest of C Ass., and buses were not described by serial number in C Ass.' registration — However, C Ass. had valid prior claim enforceable ahead of K's lease — K's primary source of income as employee of H Ltd. was complemented by her leasing business as she would have more immediate knowledge of use of her buses and financial stability of company — Leasing of buses was significant operation — K was regularly engaged in business of leasing within meaning of s. 2(1)(y)(iv) of Act, and thus was not entitled to exemption from registration.

**Personal property security --- Remedies — Miscellaneous**

Applicant C Ass. had perfected security interest in buses owned by H Ltd. — H Ltd. sold buses to respondent employee K who entered into extended year lease agreement with H Ltd. for use of buses — K did not register her lease with Personal Property Registry, nor did she search H Ltd.'s name in registry when she made purchase — H Ltd. went bankrupt, and two buses were sold and proceeds held in trust, and third bus was being used under lease agreement with K — C Ass. brought application under Personal Property Security Act making claim on buses and for unpaid purchase price of buses and for fair market value rent of one bus still in K's possession — Application granted in part — No order made regarding claim for unpaid purchase price of buses, as court had no jurisdiction under s. 66 of Act to determine issue of breach of contract and resulting award — Breach of contract not appropriate issue for application under Act, and thus no action or issue directed under s. 66 of Act — Under s. 66(1)(b) of Act, issue of amount of loss or damage sustained by C Ass. was directed to be tried — Act gives right of action to recover damages for K's refusal to deliver up to C Ass. the buses when demanded.

**Table of Authorities**

**Cases considered by *R.C. Mills J.*:**

*Bank of Montreal v. Patchrite Inc.* (2006), 2006 CarswellSask 780, 11 P.P.S.A.C. (3d) 67, 2006 SKQB 519, 290 Sask. R. 132 (Sask. Q.B.) — referred to

*Karkoulas v. Farm Credit Canada* (2005), 270 Sask. R. 291, 2005 CarswellSask 658, 2005 SKQB 367, 15 C.B.R. (5th) 107, 8 P.P.S.A.C. (3d) 249 (Sask. Q.B.) — considered

*Paccar Financial Services Ltd. v. Sinco Trucking Ltd. (Trustee of)* (1989), 9 P.P.S.A.C. 7, 57 D.L.R. (4th) 438, [1989] 3 W.W.R. 481, 73 C.B.R. (N.S.) 28, (sub nom. *Paccar Financial Services Ltd. v. Touche Ross Ltd.)* 74 Sask. R. 181, 1989 CarswellSask 32 (Sask. C.A.) — considered

**Statutes considered:**

*Personal Property Security Act, 1993*, S.S. 1993, c. P-6.2

Generally — referred to

s. 2(1)(y) "lease for a term of more than one year" (iv) — considered

s. 25 — referred to

s. 30(2) — considered

s. 30(6) — considered

s. 65(5) — referred to

s. 66 — considered

s. 66(1)(b) — referred to

**Regulations considered:**

*Personal Property Security Act, 1993*, S.S. 1993, c. P-6.2

 

*Personal Property Security Regulations*, R.R.S., c. P-6.2, Reg. 1

s. 2(1)(u)"serial numbered goods" — considered

s. 13(1) — considered

APPLICATION by creditor under *Personal Property Security Act* making claim on buses and for unpaid purchase price of buses and for fair market value rent of one bus still in respondent's possession.

***R.C. Mills J.*:**

**Introduction**

1 The applicant Concentra Financial Services Association ("Concentra"), has a perfected security interest over buses owned by Hertz Northern Bus (1993) Ltd. ("Hertz"). The respondent Albina Kille ("Kille"), purchased three buses from Hertz and then leased them back to Hertz for a period in excess of one year.

2 Hertz has gone bankrupt, Concentra claims the buses under *The Personal Property Security Act, 1993*, S.S. 1993, c. P-6.2 ("the Act"), by virtue of its perfected security interest. Kille claims the buses under s. 30(2) of the Act as a purchaser from Hertz in its ordinary course of business, or as a lessor who is not readily engaged in the business of leasing goods under s. 2(1)(y)(iv) of the Act.

**Background**

3 Concentra has a valid registered security interest in all of Hertz's buses. Hertz purchased the three buses, which are the subject of this application in 2000. Immediately thereafter, Hertz sold the buses to Kille who immediately entered into an extended year lease agreement with Hertz for use of the buses. Kille did not register her lease with the Personal Property Registry, nor did she search Hertz's name in the Personal Property Registry when she purchased the buses from it. It is conceded that Concentra has a valid security interest in the buses and their proceeds. Two of the buses have been sold and the proceeds held in trust pending the determination of this application. The third bus is being used currently by Hertz Northern Bus (2006) Ltd. under a lease agreement with Kille. The facts as established make the application of s. 30(6) the most appropriate method of analyzing the first issue as opposed to s. 30(2) of the Act. The issues arising from the application are as follows:

> 1. Does Kille come within the provisions of s. 30(6) of the Act to acquire ownership of the buses clear of Concentra's security interest?
>
> 2. If Kille owned the buses clear of Concentra's claim at the time of purchase, was she required to register a financing statement to maintain priority of the buses, or was she leasing the buses as a lessor who is not regularly engaged in the business of leasing goods under s. 2(1)(y)(iv) of the Act?
>
> 3. Is Concentra entitled to judgment for what it alleges as the unpaid purchase price of the buses and for fair market value rent of the one bus still in the possession of Kille?

***Issue No. 1 - Does Kille come within the provisions of s. 30(6) of the Act to acquire ownership of the buses clear of Concentra's security interest?***

*Facts related to Issue 1*

4 The undisputed evidence of Kille is that when she purchased the buses from Hertz, she was unaware of the security interest of Concentra. The buses were not described by serial number in Concentra's registration. Concentra had a perfected security interest pursuant to s. 25 of the Act.

**Analysis of Issue 1**

5 Section 30(6) of the Act reads as follows:

(6) Where 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:

(a) the buyer or lessee bought or leased the goods without knowledge of the security interest; and

(b) the goods were not described by serial number in the registration relating to the security interest.

6 If the goods were required to be described by serial number and were not, then Kille comes within the provisions of the section and acquires title to the buses clear of Concentra's claim. Serial number goods are defined in the Regulations to the Act under s. 2(1)(u): *"serial numbered goods"* means [among other things] a motor vehicle", and then by virtue of s. 13(1) of the Regulations, registration of a motor vehicle must include a series of items including the serial number. The registration of Concentra did not include any of the items required in s. 13(1) of the Regulations. Therefore, the buses were not described by serial number.

7 The result is clear that under s. 30(6) of the Act, Kille obtained title to the buses clear of any claim from Concentra.

***Issue No. 2 - If Kille owned the buses clear of Concentra's claim at the time of purchase, was she required to register a financing statement to maintain priority of the buses, or was she leasing the buses as a lessor who is not regularly engaged in the business of leasing goods under s. 2(1)(y)(iv) of the Act?***

*Facts related to Issue 2*

8 Kille was an employee of Hertz at the time she leased the buses to it. She had not previously been involved in leasing motor vehicles to anyone. She was not an owner or shareholder of a company that leased motor vehicles to anyone. Kille entered into a separate vehicle lease agreement for each of the three buses leased to Hertz. The lease agreements appear to be standard formal agreements which included the appropriate particulars regarding payments, interest charges, vehicle descriptions and remedies on default among other generic terms. All three leases were signed by both Hertz and Kille. The leases were all entered into on September 1, 2000.

9 Commencing in 2000, Kille filed income tax returns that showed employment income from Hertz bus lines, spousal support payments and business income. The tax return filed by Kille included a statement of business activities which stipulated that the main product of service provided was bus leasing. Expensed against that income was interest and capital cost allowance related to the buses. The tax returns up until 2002 were filed as part of the application and they all disclosed the same general information. The lease agreements provided that the maintenance, operation and licensing costs of the buses would be borne by Hertz. The leases expired in September of 2006 and shortly thereafter Hertz was petitioned into bankruptcy.

10 Kille says her motive for entering into the leases with Hertz came as a result of advice from her accountant that this opportunity was a good investment.

11 I have not considered the relative amount of income earned by Kille from her employment and business components. That factor may be one to consider in some circumstances. However, given that at all relevant times, Kille was the common law spouse of the principal shareholder of Hertz, and the level of income received as an employee for her job description appears to be inflated and more in the line of good tax planning than a genuine reflection of her efforts and focus as an employee.

**Analysis of Issue 2**

12 In *Paccar Financial Services Ltd. v. Sinco Trucking Ltd. (Trustee of)* (1989), 74 Sask. R. 181 (Sask. C.A.), our Court of Appeal determined that a person who had leased a motor vehicle for a term of more than one year but failed to register that lease meant the lessor's claim was subject to the interest of a trustee in bankruptcy. The only avenue available for Kille to get

around this result is if she can establish under s. 2(1)(y)(iv) that she is not regularly engaged in the business of leasing goods. The same argument was put forward in *Paccar*, and the Court of Appeal had the following comment to make:

> [35] ... Paccar submitted that it was not required to perfect its security under the **P.P.S.A.** by reason that it was not regularly engaged in the business of leasing goods in the province and was therefore exempt pursuant to s. 2(y)(iv) of the **Act**. The Chambers judge dealt with that issue fully and concluded that the exemption did not apply. He found that the exemption provisions in s. 2(y)(iv) were designed to exempt a person who occasionally leased goods but could not be described as making it his business. He found in this case that Paccar did not fit the description because it was a large financial institution regularly engaged in financing the purchase of Kenworth trucks, and that while lease transactions were rarely used, they were in fact used for financing and as a result the exemption did not apply. I agree with that finding.

13 The cases cited by Kille's counsel for the most part involve fact situations where the lessor was a corporation whose primary business surrounded the sale of motor vehicles, and it was clear that the business of leasing, although a minor part of the corporation's operation, was nevertheless something that fit within its operational parameters, and was used sparingly, to compliment its primary business.

14 The only situation involving an individual in the business of leasing involved a farmer and his cattle herd in which it was clear that the farmer operated through leasing contracts. Kille's counsel suggests that these cases show what kind of entity and operation result in the situation of someone being regularly engaged in the business of leasing.

15 By implication she argues the courts have not included someone in the nature of her operation in the definition, and she should gain the benefit of the exemption. Counsel for Concentra relies on the case of *Bank of Montreal v. Patchrite Inc.*, 2006 SKQB 519, 290 Sask. R. 132 (Sask. Q.B.). In this decision, Zarzeczny J. reviews all the cases brought to my attention. He quotes with approval a comment from Ball J. in *Karkoulas v. Farm Credit Canada*, 2005 SKQB 367, 270 Sask. R. 291 (Sask. Q.B.) at para. 20:

> [20] ... it is not the number or frequency of the leases that determines the application of the **PPSA**; it is whether the lease involved a lessor who was regularly engaged in leasing the goods.

16 Zarzeczny J. went on to find that Patchrite was regularly engaged in the business of leasing. Since it appeared its only corporate business was an equipment lease to a company called Sweeprite, and since it had no other business, it had to be regularly engaged in the business of leasing.

17 None of the cases is on point with the factual situation I am facing. The situation most similar is the Patchrite decision of ZarzecznyJ. Kille has three separate, independent and enforceable lease agreements for terms of five years. She utilizes the capital cost expense as an effective method of reducing taxable income. It appears that her accountant's advice that the buses were a good investment is correct. Her primary source of income as an employee of Hertz is complimented by her leasing business as she would have more immediate knowledge of the use of her buses and the financial stability of the company. In her personal circumstances, the leasing of the buses is a significant operation. I conclude that Kille was regularly engaged in the business of leasing within the meaning of s. 2(1)(y)(iv) of the Act and therefore, is not entitled to an exemption from registration. Concentra has a valid prior claim enforceable ahead of her lease.

***Issue No. 3 - Is Concentra entitled to judgment for what it alleges as the unpaid purchase price of the buses and for fair market value rent of the one bus still in the possession of Kille?***

*Facts related to Issue 3*

18 Concentra has sought to establish that Kille only paid a portion of the purchase price to Hertz in 2000, and that Hertz is still owed $32,500 from the original sale, and that Concentra is entitled to a judgment for that amount against her. There is no authority cited for this proposition. Under s. 66 of the Act, I can make an order determining questions of priority or entitlement to collateral, to direct an action to be brought or an issue to be tried. Under the Act, I do not see how I am entitled to determine that

  

there has been a breach of contract between Hertz and Kille that would result in Concentra being awarded a judgment. It may be that the receiver stepping into the shoes of Hertz, has an action against Kille. If so, that can be commenced and the facts proven.

19 Even if I had jurisdiction, the factual allegations relating to this issue regarding payment of the purchase price are disputed in the competing affidavits, and I would not be able to make a determination of the breach of contract. This issue does not appear to me to be an appropriate issue for an application under the Act, and so I decline to direct an action or issue under s. 66 of the Act.

20 Concentra also seeks damages in the sum of $800 per month from September 1, 2006 until the remaining bus is delivered to it. Concentra states that Kille has retained possession of this bus contrary to Concentra's security position, and in fact has entered into a lease agreement with Hertz Northern Bus (2006) Ltd. in which she receives $800 per month under the lease agreement for the bus. The factual allegations are not denied by Kille. Section 65(5) reads:

> 65(1) If a person, without reasonable excuse, fails to discharge any duties or obligations imposed on the person by this Act, the person to whom the duty or obligation is owed has a right to recover loss or damage that was reasonably foreseeable as liable to result from the failure.

21 This section applies to Kille. It gives a right of action to recover damages for Kille's refusal to deliver up to Concentra the buses when demanded.

22 From the affidavit material, I am not satisfied what is the appropriate amount of loss or damage foreseeable from this failure. The amount of income generated from Hertz Northern Bus (2006) Ltd. under the lease agreement is a possible calculation of damages, but given the relationship between Kille and Hertz Northern Bus (2006) Ltd., and the fact that this lease agreement was likely not available to Concentra, the use of the figure of $800 per month may not be appropriate.

23 In addition, Concentra has been deprived of the use of the proceeds from two of the buses which have been disposed of and the money is held in trust.

24 Under s. 66(1)(b), I direct that an issue be tried on the question of the amount of loss or damage sustained pursuant to s. 65(5) by Concentra.

25 Specifically, I have not included Concentra's claim for $32,500 in any of the orders made. Concentra will have to determine in what fashion a claim can be advanced against Kille, and Kille should be entitled to raise all defences, including limitations if applicable in relation to that action. To direct a trial of that issue in this venue may compromise the rights of Kille to do so.

26 The following orders are therefore made as a result of the above decision:

1. The applicant is entitled to priority over the respondent in respect of the following school buses leased by the respondent to Hertz Northern Bus (1993) Ltd.:

   a) a 1993 IHC 54 Premier Yellow Bus, serial number 1HVBAZRM3PH538097;

   b) a 1994 GMC 22 Bluebird Bus, serial number 1GDHG31K6RF507555;

   c) a 1991 GMC 20 Giradin Bus, serial number 2GBGG35K3M4140417.

2. That the law firm of McKercher McKercher & Whitmore LLP pay to the applicant the sum of $3,800 representing insurance proceeds held by them with respect to the 1994 GMC 22.

3. That 623452 Saskatchewan Ltd., operating as Grasswood Auctions, to pay to the applicant the sum of $1,800, representing sale proceeds of the 1991 GMC 20 Giradin.

4. That the respondent immediately deliver possession of the 1993 IHC 54 Premier to the applicant, and in the event that delivery of this bus is not made within three days of service of this order upon the respondent's solicitor, then

the respondent shall pay the sum of $50 per day to the applicant for every day that the respondent retains possession of the bus until delivery to the applicant.

5. I further order that a trial of the issue of entitlement in the amount of damages pursuant to s. 65(5) of the Act be held to determine the loss of Concentra for the failure of the respondent to deliver the buses named above to the applicant on September 1, 2006.

27 I order that the costs of this application which I fix at $750 be paid by the respondent to the applicant forthwith.

*Application granted in part.*

End of Document

# TAB 3

2005 NBQB 429
New Brunswick Court of Queen's Bench

Canadian Imperial Bank of Commerce v. CTV Television Inc.

2005 CarswellNB 776, 2005 NBQB 429, [2005] N.B.J. No. 567, 145 A.C.W.S. (3d) 317, 18 C.B.R. (5th) 217, 296 N.B.R. (2d) 246, 769 A.P.R. 246, 9 P.P.S.A.C. (3d) 78

# Canadian Imperial Bank of Commerce (Applicant) and CTV Television Inc. (Respondent)

Glennie J.

Heard: February 8, 2005
Oral reasons: February 8, 2005
Written reasons: October 31, 2005
Docket: S/M/4/05

Counsel: Raymond P. Gorman, Q.C. for Canadian Imperial Bank of Commerce
Edwin G. Ehrhardt, Q.C., Kelsey Bingham for CTV Television Inc.

Subject: Corporate and Commercial; Insolvency; Property; Contracts

**Related Abridgment Classifications**
For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

**Headnote**

**Personal property security --- Priority of security interest — Security interests versus other interests — Judgment creditors**

Bank held general security agreement (GSA) over present and after-acquired property of corporation — GSA did not specifically identify any equipment by serial number — GSA was registered in August 1996 and then renewed in July 2001 and June 2004 — Judgment creditor obtained judgment against corporation in February 2004 — Judgment creditor registered in personal property registry system under Creditors Relief Act in April 2004 against all corporation's present and after-acquired property — Judgment creditor's original registration did not contain serial numbers but it later amended registration to include serial number of three trucks, tractors and trailers — Sheriff seized two of vehicles listed by serial number at judgment creditor's direction — Bank brought application for order under s. 67 of Personal Property Security Act (PPSA) for determination of priority between bank and judgment creditor — Bank's GSA ranked in priority to judgment creditor's registered judgment — Security interests over serial numbered goods held as equipment need only general description to be perfected — Bank's GSA was perfected by using general description pursuant to s. 25 of PPSA — Bank's security interest was effective against subsequent judgment creditor under s. 20 of PPSA — Serial number description for equipment was necessary only to obtain priority over purchaser or competing secured creditor who registered by serial number and there was no equivalent provision in PPSA or Creditors Relief Act applicable to judgment creditors.

**Table of Authorities**

**Cases considered by *Glennie J.*:**

*GMAC Leaseco Ltd. v. Moncton Motor Home & Sales Inc. (Trustee of)* (2003), 2003 NBCA 26, 2003 CarswellNB 161, 2003 CarswellNB 162, 42 C.B.R. (4th) 43, 227 D.L.R. (4th) 154, 4 P.P.S.A.C. (3d) 211, 257 N.B.R. (2d) 141, 674 A.P.R. 141 (N.B. C.A.) — considered

**Statutes considered:**

*Creditors Relief Act*, R.S.N.B. 1973, c. C-33

Generally — referred to

s. 2.2(1) [en. 1993, c. 36, s. 2] — considered

s. 2.3(1) [en. 1993, c. 36, s. 2] — considered

s. 2.3(7) [en. 1993, c. 36, s. 2] — considered

*Personal Property Security Act*, S.N.B. 1993, c. P-7.1

Generally — referred to

s. 1 "consumer goods" — considered

s. 1 "equipment" — considered

s. 1 "inventory" — considered

s. 1 "security interest" — considered

s. 3(1) — referred to

s. 12(1) — considered

s. 19 — considered

s. 20 — considered

s. 24 — considered

s. 25 — considered

s. 30 — referred to

s. 30(6) — considered

s. 30(7) — considered

s. 34 — referred to

s. 34(1) — referred to

s. 35 — considered

s. 35(1) — considered

s. 35(4) — considered

s. 35(6) — considered

s. 35(7) — referred to

s. 35(8) — referred to

s. 67 — referred to

**Regulations considered:**

*Personal Property Security Act*, S.N.B. 1993, c. P-7.1
*General Regulation — Personal Property Security Act*, N.B. Reg. 95-57

s. 2 "serial numbered goods" — referred to

s. 23(1) — considered

s. 24 — considered

s. 25(1) — considered

s. 45 — considered

APPLICATION by bank for determination of priority between bank's general security agreement and judgment creditor's registered judgment.

***Glennie J.* (orally):**

1 This application involves a priority dispute under the New Brunswick Personal Property Security Act (the "PPSA") between a bank, as the holder of a General Security Agreement from a corporation, and a judgment creditor, as the holder of a registered judgment against the same corporation.

**Overview**

2 Canadian Imperial Bank of Commerce ("CIBC"), holds a General Security Agreement ("GSA") over the present and after acquired undertaking and personal property of G. W. Trucking Ltd. ("GW Trucking"). The GSA is dated August 17, 1996 and was renewed on July 18, 2001 and further renewed on June 14, 2004. The outstanding liability of GW Trucking to CIBC is approximately $75,000.00. The GSA did not specifically identify the equipment owned by GW Trucking by serial number and, in particular, two trucks owned by GW Trucking that are the subject matter of this application were not specifically listed in the GSA.

3 Pursuant to the GSA, GW Trucking granted the following security interest to CIBC:

> Grant of Security. The Customer mortgages, charges and assigns to CIBC, and grants to CIBC, and CIBC takes, a Security Interest in the property described in the following paragraph or paragraphs of this section and in all property described in any schedules, documents or listings that the Customer may from time to time sign and provide to CIBC in connection with this Agreement, and in all present and future Accessions to, and all Proceeds of, any such property (collectively, the "Collateral") as a general and continuing collateral security for the due payment and performance of the Liabilities: ...
>
> (b) All Personal Property: all of the Customer's present and after-acquired undertaking and Personal Property (including any property that may be described in Schedule A) but excluding Consumer Goods.

4 There is no property specifically described or identified in Schedule "A" to the GSA.

5 CTV Television Inc. ("CTV"), obtained a judgment in the amount of approximately $75,000.00 against GW Trucking on February 18, 2004. That judgment did not identify any equipment owned by GW Trucking and, in particular, did not identify the two trucks that are the subject matter of this application.

 

6 The CTV judgment was registered in the New Brunswick Personal Property Registry System ("PPRS") as a Creditors Relief Act Notice of Judgment on April 13, 2004 as number 10851681 (the "Original Registration") for a period of five years. The Original Registration was registered against the present and after acquired personal property of GW Trucking as described in the General Description Collateral field of the PPRS.

7 Subsequent to the Original Registration, CTV obtained the serial numbers of certain trucks, tractors and trailers owned by GW Trucking and amended the Original Registration to add the serial numbered descriptions of these vehicles in the Serial Number Collateral field of the PPRS.

8 In particular, the Original Registration was amended as follows:

(a) On June 25, 2004 by Amendment no. 11157955 adding in serial numbered descriptions for a 1982 International Tractor/ Truck, a 1979 Highway Trailer, a Ford Farm Tractor & snow blower model 4610, a 1979 highway model trailer, a 1986 trailer, a 1998 International Eagle Road Tractor, a 1995 International Road Tractor Pro and a 1998 International Eagle Road Tractor.

(b) On November 26, 2004 by Amendment no. 11701224 by adding in serial numbered descriptions for a Ford Farm Tractor & snow blower model 4610, a 1995 International Road Tractor # 116, a 1998 International Eagle Road Tractor and a 1999 International SG475.

(c) On November 30, 2004 by Amendment no. 11710209 by adding in the serial numbered description for a 1998 International Truck.

9 As mentioned, no specific personal property or serial numbered collateral is described in the GSA or in any schedules attached thereto. In particular, none of the vehicles described in the amendments to the Original Registration by CTV are described in either the GSA, any schedules to the GSA or in the CIBC Financing Statement.

10 The CIBC GSA was registered pursuant to the PPSA prior to the CTV judgment.

11 Pursuant to an Order for Seizure and Sale, the Sheriff for the Judicial District of Moncton was directed by CTV to seize and sell assets of GW Trucking sufficient to satisfy the Order for Seizure and Sale. In particular, the Sheriff was directed to seize three of the vehicles described in the amendments to the Original Registration. The Sheriff was able to locate and seize two International Trucks bearing serial numbers 2HSFMAHR9TCO12160 and HTFN0004WC038881.

12 CIBC disputes this seizure and has applied for an Order pursuant to Section 67 of the PPSA for a determination of priority between CIBC and CTV pursuant to their registrations under the PPRS.

13 CIBC asserts that the GSA it holds over all present and after acquired property of GW Trucking ranks in priority to CTV's registered judgment because equipment need not be described by serial number under the PPSA. It is optional.

14 CTV argues that collateral that is equipment may be described either as general collateral or by serial number, but, if it is not described by serial number, it is left vulnerable to security interests taken in the same equipment that are registered by serial number.

15 The vehicles described by serial number in the amendments to the Original Registration by CTV are serial numbered goods as defined in the General Regulation to the PPSA. The vehicles are not consumer goods of the debtor, GW Trucking, but rather, they are equipment. They were described by serial number in the amendments to the Original Registration by CTV. The CIBC Financing Statement does not contain any serial numbered description, but rather a generic description in the general collateral field of all of the debtor's present and after acquired personal property. CTV asserts that the CIBC Financing Statement is unperfected with respect to any registrations which do describe serial numbered goods by their serial number.

 

16 CTV also argues that its notice of judgment registered in the PPRS pursuant to the Creditors Relief Act and the PPSA which describes the contested collateral by serial number trumps CIBC's financing statement which contains only a general description of GW Trucking's collateral and that, with respect to that serial numbered equipment, the CTV judgment has priority over CIBC's GSA.

***The Relevant Legislation***

*(a) The New Brunswick Personal Property Security Act*

17 The New Brunswick PPSA defines consumer goods, inventory, equipment and security interest as follows:

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

"inventory" means goods that are

(a) held by a person for sale or lease, or that have been leased by that person as lessor,

(b) to be furnished or that have been furnished under a contract of service,

(c) raw materials or work in progress, or

(d) material used or consumed in a business or profession;

"equipment" means goods that are held by a debtor other than as inventory or consumer goods;

"security interest" means

(a) an interest in personal property that secures payment or performance of an obligation, but does not include the interest of a seller who has shipped goods to a buyer under a negotiable bill of lading or its equivalent to the order of the seller or to the order of an agent of the seller, unless the parties have otherwise evidenced an intention to create or provide for a security interest in the goods, and

(b) the interest of

(i) a consignor who delivers goods to a consignee under a commercial consignment,

(ii) a lessor under a lease for a term of more than one year,

(iii) a transferee under a transfer of an account or a transfer of chattel paper, and

(iv) a buyer under a sale of goods without a change of possession,

that does not secure payment or performance of an obligation;

18 The PPSA sets out the requirements for attaining perfection at sections 12, 19, 24 and 25:

**When attachment occurs**

**12(1)** A security interest, including a security interest in the nature of a floating charge, attaches when

(a) value is given,

(b) the debtor has rights in the collateral, and

(c) except for the purpose of enforcing rights as between the parties to the security agreement, the security interest becomes enforceable within the meaning of s. 10.

**Attaining perfection**

**19** A security interest is perfected when

(a) it has attached, and

(b) all steps required for perfection under this Act have been completed, regardless of the order of occurrence.

**Perfection by possession**

**24(1)** Subject to section 19, possession of the collateral by the secured party, or on the secured party's behalf by another person, perfects a security interest in

(a) goods,

(b) a negotiable document of title,

(c) chattel paper,

(d) a security,

(e) an instrument, and

(f) money.

**24(2)** A secured party does not have possession of collateral for the purposes of subsection (1) if

(a) the collateral is in the actual or apparent possession or control of the debtor or the debtor's agent, or

(b) possession is the result of seizure or repossession.

**Perfection by registration**

**25** Subject to section 19, registration of a financing statement perfects a security interest in collateral.

19 The provisions of the PPSA governing priority and subordination are found at sections 20 and 35.

20 Section 20 of the PPSA deals with Subordination of unperfected security interests as follows:

**20(1)** An unperfected security interest in collateral is subordinate to the interest of

(a) a judgment creditor who has registered a notice of judgment in the Registry pursuant to subsection 2.2(1) of the *Creditors Relief Act* if the security interest is unperfected when the notice is registered,

(b) all persons entitled by the *Creditors Relief Act* or otherwise to participate in a distribution of personal property subject to the interest of a creditor referred to in paragraph (a) and

(c) a sheriff and a representative of creditors for the purpose of enforcing the rights of a creditor referred to in paragraph (a).

**20(2)** An unperfected security interest in collateral is not effective against

 

(a) a trustee in bankruptcy if the security interest is unperfected at the time of the bankruptcy,

(b) a liquidator appointed under the *Winding-up Act* (Canada) if the security interest is unperfected when the winding-up order is made, or

(c) a creditor, assignee or sheriff who has registered a notice of claim in the Registry pursuant to subsection 2.4(1) of the *Creditors Relief Act* for the purposes of any enforcement proceedings commenced under the Acts referred to in that subsection if the security interest is unperfected at the time the notice of claim is registered.

21 Section 35 of the PPSA deals with Residual (General) Priority Rules as follows:

**35(1)** Where this Act provides no other method for determining priority between competing security interests in the same collateral, the following priority rules apply:

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

(i) the registration of a financing statement under section 25 without regard to the time of attachment of the security interest,

(ii) possession of the collateral under section 24 without regard to the time of attachment of the security interest, or

(iii) perfection under sections 5, 7, 26, 29 or 74,

whichever is earliest;

(b) a perfected security interest has priority over an unperfected security interest; and

(c) priority between unperfected security interests is determined by the order of attachment of the security interests.

**35(4)** A security interest in goods that are equipment and are of a kind that are prescribed as serial numbered goods is not registered or perfected by registration for the purposes of subsection (1), (7) or (8) or 34(1) unless a financing statement relating to the security interest that includes a description of the goods by serial number is registered.

**35(6)** A perfected security interest has priority over the interest of a judgment creditor referred to in paragraph 20(1)(a) only to the extent of

(a) advances made before the judgment creditor registers the notice of judgment referred to in paragraph 20(1)(a),

(b) advances made before the secured party has knowledge of the registration of the notice of judgment referred to in paragraph 20(1)(a),

(c) advances made in accordance with a statutory requirement, or a legally binding obligation owing to a person other than the debtor entered into by the secured party before acquiring the knowledge referred to in paragraph (b), and

(d) reasonable costs and expenses incurred by the secured party for the protection, preservation, maintenance or repair of the collateral.

***The General Regulation under the PPSA***

22 New Brunswick Regulation 95-57 under the PPSA (the "General Regulation") sets out the requirements for describing collateral in a PPRS registration as follows at sections 23, 24, 25 and 45:

"serial numbered goods" means a motor vehicle, trailer, mobile home, aircraft, boat or an outboard motor for a boat.

 

**Collateral (and Proceeds) Description**

**23(1)** Subject to subsection (2), where collateral to which a registration relates is

(a) consumer goods that are serial numbered goods, the registrant shall enter a description of the collateral in accordance with section 25,

(b) consumer goods that are not serial numbered goods, the registrant shall enter a description of the collateral in accordance with section 24,

(c) equipment that is serial numbered goods, the registrant shall enter a description of the collateral in accordance with section 24 or 25;

(d) equipment that is not serial numbered goods, the registrant shall enter a description of the collateral in accordance with section 24.

**General Description of Collateral**

**24(1)** Where collateral is to be described other than by serial number, the registrant shall enter

(a) a description of the collateral by item or kind or by reference to one or more of the following: "goods", "document of title", "chattel paper", "security", "instrument", "money" or "intangible",

(b) a statement that a security interest is taken in all of the debtor's present and after-acquired personal property, or

(c) a statement that a security interest is taken in all of the debtor's present and after-acquired personal property except specified items or kinds of personal property or except one or more of the following: "goods", "document of title", "chattel paper", "security", "instrument", "money" or "intangible".

**24(2)** A description is inadequate for the purpose of paragraph (1)(a) if it describes the collateral as consumer goods or equipment without further describing the item or kind of collateral, but where the property to be excluded from a description of collateral under subparagraph (1)(c) is the consumer goods of the debtor, the excluded property may be described simply as consumer goods.

**24(3)** A description of collateral under subsection (1) that describes the collateral as inventory is adequate only while the collateral is held by the debtor as inventory.

**Description of Serial Numbered Goods**

**25(1)** Where collateral is to be described by serial number, the registrant

(a) shall indicate the type of serial numbered goods to which the registration relates by entering or selecting the appropriate code,

(b) shall enter the last twenty-five characters of the serial number or all the characters if the serial number contains less than twenty-five characters,

(c) may verify the serial number by entering it a second time, and

(d) may describe the collateral by make, manufacturer, model, model year or any other particulars.

**Description by Serial Numbered Goods**

**45(1)** The registrant shall enter, in accordance with section 25, a description of personal property of the judgment debtor that is consumer goods that are serial numbered goods and, in such a case, section 25 applies with the necessary modifications.

**45(2)** The registrant may enter, in accordance with s. 25, a description of the personal property of the judgment debtor that is equipment that is serial numbered goods and, in such a case, s. 25 applies with the necessary modifications.

**The Creditors Relief Act**

23 The New Brunswick *Creditors Relief Act*, c. C-33 provides for the registration of a Notice of Judgment under the PPSA as follows:

**2.2(1)** A judgment creditor who has obtained a money judgment may register a notice of judgment in the Registry in accordance with the regulations under the *Personal Property Security Act.*

**2.3(1)** Personal property of a judgment debtor shall not be bound except by registration of a notice of judgment in accordance with subsection 2.2(1).

**2.3(7)** For the purposes of subsection 20(1) of the *Personal Property Security Act* and subject to section 22 of that Act, the non-exempt exigible personal property of a judgment debtor and the non-exempt attachable debts of a judgment debtor are bound by registration of a notice of judgment notwithstanding that the security interest referred to in subsection 20(1) of the *Personal Property Security Act* attached before the notice of judgment was registered.

**Analysis**

24 In her text, *An Introduction to the New Brunswick Personal Property Security Act*, Professor Catherine Walsh writes at pages 110 and 111:

Priority between secured parties and judgment creditors under the PPSA

The most significant difference between s. 20 of the New Brunswick *Act* and its counterparts in other PPSA jurisdictions is the rule governing priority between a security interest taken under the *Act* and the interest of a judgment creditor. Under the Ontario and western *Acts*, an unperfected security interest is subordinate to the interest of a judgment creditor only if the judgment creditor has pursued judgment enforcement proceedings to the point of seizure or its equivalent before the security interest is perfected. However, when New Brunswick adopted its PPSA, reform of judgment enforcement law was in the air, enabling it to take the next logical step in the evolution of the law governing priority between judgment creditors and secured parties.

S. 20(1)(a) abandons the traditional linkage between the priority rights of judgment creditors and the judgment enforcement process. Judgment creditors are not required to even initiate enforcement proceedings, let alone take that process to the point of seizure, in order to assert priority over an unperfected security interest. All they need do is register notice of their judgment in the Personal Property Registry, something which amendments to the *Creditors Relief Act*, proclaimed in force at the same time as the PPSA, permits them to do as soon as judgment is obtained. Once notice of the judgment is registered, the debtor's present and after-acquired personal property is bound in the amount of the judgment. Registration binds the property for the amount of the judgment, costs and accrued interest, less any amounts paid to satisfy the judgment. Provided the notice of judgment is registered before the security interest is perfected, s. 20(1)(a) of the PPSA gives priority to the interest of the judgment creditor.

A registered judgment has priority over an unperfected security interest regardless of whether the security interest attaches before or after the judgment is registered. In cases where the security interest attaches *before* the judgment is registered, but is not yet perfected in the procedural sense of registration or taking possession, the *Creditors Relief Act* expressly provides that the registered judgment has priority. In cases where the security interest does not attach until *after* the judgment is registered, the security interest is postponed by PPSA s. 20(1)(a) even if the security interest was registered before the judgment was registered. This is because, under s. 19, a security interest is perfected only when it has attached *and* all procedural perfecting steps have been completed. Since s. 20(1)(a) subordinates an *unperfected* and not merely an *unregistered* security interest to a registered judgment, both attachment and registration of the security interest must precede the registration of the judgment in order for the security interest to have priority. This result is justified because it is attachment and not registration that gives the secured party its proprietary interest in the debtor's property. In contrast, the judgment creditor has done everything possible to "perfect" his or her interest — sued the debtor to judgment and then registered that judgment.

25 Professor Walsh writes at page 148 of her text in Note 10:

A security interest in serial numbered equipment that is not described by serial number in the registered financing statement is also subordinated to a security interest in the same equipment that is registered against serial number: see further s. 35(4) and commentary on s. 43. <u>The net effect is that the equipment financier retains full priority only over a trustee in bankruptcy and a judgment creditor.</u>

(Emphasis added)

26 It should be noted that CTV is a registered judgment creditor and is not a secured party because no security interest has been given to CTV to secure the performance of an obligation. (See Section 3(1) of the PPSA).

27 In *GMAC Leaseco Ltd. v. Moncton Motor Home & Sales Inc. (Trustee of)*, [2003] N.B.J. No. 140, 2003 CarswellNB 161, 42 C.B.R. (4th) 43 (N.B. C.A.), Justice Robertson writes at paragraphs 29 to 32:

**Inclusion of Serial Numbers — Mandatory or Optional**

29 There are only two ways for a searcher to identify the existence of a registered financing statement; a search using the debtor's name or, in cases where the collateral qualifies as "serial numbered goods", a search by serial number. This leads one to ask whether registration by serial number is mandatory.

30 Under the New Brunswick scheme, there are three sub-categories of goods; (1) inventory; (2) equipment; and (3) consumer goods. Section 2 of the *General Regulation — Personal Property Security Act, 95-57, adopted under the NBPPSA*, defines certain types of goods as "serial numbered goods". For present purposes, it is sufficient to appreciate that a motor vehicle comes within the definition. Thus, a truck is a serial numbered good that qualifies as a consumer good, equipment or inventory.

31 If the collateral qualifies as serial numbered consumer goods, the collateral must be described by serial number: *see General Regulation* s. 23(1). Consumer goods are defined, in s. 1 of the NBPPSA, as goods used, or acquired for use, primarily for personal, family or household purposes.

32 If the serial numbered goods qualify as equipment, registration is optional in the limited sense that a serial number description is not required to effect a valid registration: see *General Regulations* s. 23(1)(c) and ss. 24 & 25. A general description of the collateral is sufficient. But there is a price to be paid for not including the serial number in the financing statement. The registrant's security interest is subordinated to the interest of subsequent buyers and lessees of the equipment, without knowledge, and to other security interests in the same equipment that are registered with reference to the serial number: see ss. 30(6), (7) and 35(4) of the *NBPPSA*. The net effect is that the equipment financier who elects not to include serial numbers in the financing statement can only assert priority over a trustee in bankruptcy and a judgment creditor: see Walsh at 148 and note 10.

And at paragraph 35 Justice Robertson concludes:

35 In summary, only serial numbered consumer goods need be described by serial number. In all other cases, inclusion of the serial number in the financing statement is optional.

 

28 In a paper entitled "*The New Brunswick PPSA Regime: A Primer*" which was delivered to a New Brunswick Continuing Legal Education Banking Law Conference on September 24, 1993, Professor Walsh writes at page 36:

> Under the Regulations, serial number registration will be mandatory only if the serial numbered goods are classified as consumer goods. If they are classified as equipment, registration by serial number will be optional. However, the PPSA gives secured parties a strong incentive to exercise that option. A secured party who fails to register the serial number of serial numbered goods held as equipment is protected only as against the debtor's execution creditors or trustee in bankruptcy. Buyers or lessees of the collateral will take free of the security interest and it will be treated as unperfected as against other secured parties: see sections 30(6) and (7) and section 35(4).
>
> (Emphasis added)

29 For the reasons that follow, I am of the opinion that CIBC's GSA ranks in priority to CTV's registered judgment.

30 There is no doubt that a prior registered security interest in equipment would lose out in priority to a purchaser with value without notice or to any subsequent perfected security interest that describes the collateral by serial number. However, in my opinion, the prior registered security interest contained in a GSA has priority over a trustee in bankruptcy and a judgment creditor. See Sections 30(6), 30(7) and 35(4) of the PPSA.

> 30(6) A buyer or lessee of goods takes free of a security interest in the goods perfected by registration under section 25 if
>
> > (a) the buyer or lessee bought or leased the goods without knowledge of the security interest, and
> >
> > (b) in the registration relating to the security interest, the goods were not described by serial number entered into the field labeled for the receipt of serial numbers.
>
> 30(7) Subsection (6) applies only to goods that are equipment and that are of a kind that are prescribed as serial numbered goods.

31 As mentioned, Section 35(4) of the PPSA reads as follows:

> A security interest in goods that are equipment and are of a kind that are prescribed as serial numbered goods is not registered or perfected by registration for the purposes of subsection (1), (7) or (8) or 34(1) unless a financing statement relating to the security interest that includes a description of the goods by serial number is registered.

32 It should be noted that the provisions of Section 35(1), (7) and (8) and Section 34(1) deal exclusively with competitions between security interests and do not cover competitions between security interests and judgment creditors. Since the security interest is considered unperfected pursuant to section 35(4) only for the purposes of the situations dealt with by the referenced subsections, it remains perfected for other types of competitions, assuming registration has been effected using a general description pursuant to section 25 of the PPSA, and therefore prevails over a subsequent judgment creditor.

33 In the present case, registration of CIBC's GSA has been effected by using a general description pursuant to Section 25 of the PPSA.

34 Serial numbered goods that are held by a debtor as consumer goods must be described by serial number in the registration to be considered perfected as against third parties. This is evident from the regulations governing the registration requirements for serial numbered consumer goods.

35 However, the situation is different for serial numbered goods held as equipment. In cases where serial numbered goods are held as equipment, the security interest will be considered perfected with only a general description.

36 With respect to serial numbered goods held as equipment, the regulations state that a secured party may, not must, include a serial number description. It is optional.

37 A perfected security interest is effective as against a subsequent judgment creditor or trustee pursuant to Section 20 of the PPSA.

38 A serial number description for equipment is necessary only to obtain priority over a buyer or over a competing secured creditor who has registered by serial number. See Sections 30(6), 30(7) and Section 35(4) of the PPSA. There is no equivalent exception in the PPSA or in the *Creditors Relief Act* to protect judgment creditors and trustees in bankruptcy.

39 The reason for the difference in treatment is apparent. Serial number description is considered necessary to protect detrimental reliance by buyers and subsequent secured creditors who give new value against equipment after having conducted a serial number search that does not disclose the equipment. A judgment creditor and a trustee, as the representative of unsecured creditors, do not require this additional protection because they do not rely in the sense of giving fresh value in reliance upon a serial number search.

40 The reason judgment creditors are required to register by serial number is because registration binds the goods against subsequent transferees. Accordingly, to protect subsequent buyers and subsequent secured creditors from the binding effect of the judgment, serial number registration is needed just as it is needed for security interests. However, in my opinion, serial number registration by judgment creditors does not create priority against previously registered secured creditors whether or not they have registered by serial number. The reason, as I have stated, is that there is no risk of detrimental reliance in the form of giving new value to the debtor in the case of judgment creditors.

41 The statutory reason is simply the absence of any explicit exception for judgment creditors who register by serial number of the kind found in Sections 30 and 34 of the PPSA for buyers and secured creditors to take away from the normal effectiveness of a perfected security interest against third parties pursuant to Section 20 of the PPSA.

**Conclusion and Disposition**

42 In the result, I conclude that CIBC's General Security Agreement takes priority over CTV's judgment. An order will issue to that effect pursuant to Section 67 of the PPSA.

43 CIBC is entitled to costs in the amount of $1,200.00, inclusive of disbursements.

*Order accordingly.*

End of Document

# TAB 4

security interest. Actual knowledge, as opposed to constructive notice, is required. Even though a security interest in an instrument or document of title may be perfected by possession (ss. 22(c), 22 (e)), by registration (s. 23) or automatically for ten days (s. 24), s. 28 will only apply where the security interest has been perfected by registration or by the temporary perfection provision. This provision is required to nullify the effects of a registered security interest in collateral which has historically passed between parties in the commercial world in negotiable form and is possessed to maintain the rights it represents. When the security interest is merely registered in this type of collateral, it represents a lesser quality of interest than the rights of a purchaser of that same collateral who then possesses it.

Instruments deposited into an account at a financial institution may fall within the scope of s. 28(4). For deposits into an account in negative balance, the deposit-taking institution may be within the definition of "purchaser" of the instrument and the credit given to reduce the amount in overdraft may qualify as "value" under s. 28(4)(a). This was held to be the case under a similar provision in another provincial jurisdiction in which the deposit-taking institution was extended priority over a perfected secured party with a security interest in instruments as proceeds and an interest in the deposit account funds as proceeds. It is unlikely a deposit-taking institution could apply s. 28(4) for instruments deposited into an account in positive balance as it is merely a creditor giving provisional credit to its customer until it is paid. The instrument is processed through the Canadian payments clearing system and paid to the institution.

## Section 28(5)

Section 28(5) applies to dispositions of motor vehicles, a term defined in O. Reg. 56/07, which are equipment to the seller (that is, goods which are not inventory or consumer goods), where the sale is not in the ordinary course of business. Section 28(5) will allow the buyer to take the motor vehicle free from any security interest given by the seller, unless the VIN is set out in the designated place on the financing statement or financing change statement, or the buyer knew the sale constituted a breach of the security agreement. The provision is intended to encourage the registration of the VIN when completing the optional description of a motor vehicle that is equipment. By so doing, the integrity of the system is enhanced.

"Motor vehicle" is given a broad definition by s. 1 of O. Reg. 56/07, where it is said to include an "automobile, motorcycle, motorized snow vehicle and any other vehicle that is self-propelled." A motor vehicle does not include a street car or other vehicle running only upon rails, a farm tractor, an implement of husbandry, a machine acquired for use or used as a road-building machine, or a craft intended primarily for use in the air or in or upon the water. The definition will include such things as ski-doos, all terrain vehicles, go-carts, lawnmowers and the like.

This subsection uses the term "buyer" instead of "purchaser." See the discussion in s. 28(1). "Vehicle Identification Number" is defined in s. 1 of the Minister's Order made under the *Personal Property Security Act*, O. Gaz. 2007.2263 to mean the number that the person who constructed the motor vehicle affixed to it for identification purposes. A search can be made using either a debtor name or a VIN, or both. A VIN is therefore a separate and distinct search criterion, which is vital to the effective operation of the registry. Sections 3(7) and (9) of the Minister's Order only require that a VIN be registered if the vehicle is consumer goods. Section 3(8) of the Minister's Order gives the option to register a VIN when the goods are equipment. Such registration is not mandatory when the goods are equipment, but a failure to do so carries with it the possibility of subordination of the interest by operation of s. 28(5).

Although the s. 28(5) subordination rule will not apply where the buyer knew that the sale constituted a breach of the security agreement, a buyer who knew of the existence of a security interest but did not know that the sale transaction constituted a breach thereof can still claim protection under this provision.

Where someone prior to the seller gave a security interest in the motor vehicle, s. 28(5) will not be effective against the secured party, as it is effective only against security interests "given by the seller". Therefore it is in the best interests of a potential buyer to conduct a search of the Act registry to determine if such a security interest exists. When searching the registry, however, a problem similar to that encountered in ss. 28(1) and (2) will be encountered, namely, the ability of a potential buyer to determine the existence of an antecedent secured party is made difficult if the buyer does not know the names of all the parties who previously held an interest in the goods. In these circumstances, the only basis upon which a buyer can conduct a search is on the identification serial number of the good, if one exists.

### Section 28(6)

The Act permits a security interest to be registered against a security as collateral. A purchaser of a security who is not a secured party, gives value, does not know the transfer constitutes a breach of a security agreement, and obtains control of the security acquires the security free from a security interest under s. 28(6). The purpose of this section is to protect lenders who take possession of a security as collateral, as, for example, in an overnight loan transaction. In this situation, perfection by control is more effective than perfection by registration.

Section 1(2) defines the concept of control for the purposes of the PPSA. It is an additional method of achieving perfection under the Act and can bring with it superior priority rights to a perfection achieved through the registration of a financing statement. The subsection describes the criteria used to determine when a secured party has control of various types of investment property. The criteria used to determine whether a secured party has obtained control references the STA and the methods differ depending on the type of investment property in question. Separate sets of rules are set out for certificated securities, uncertificated securities, security entitlements, and futures contracts. The determination of control of certificated securities, uncertificated securities, and security entitlements is as described in the appropriate sections of the STA. The rules for the determination of control of a futures contract are set out directly in this section, since futures contracts are expressly excluded from the scope of the STA under s. 16 of that Act.

### Section 28(7)

Subsection 28(7) outlines to what extent the purchaser is obligated to investigate potential security claims by not requiring a purchaser to investigate the implications

THE 2015 ANNOTATED

# ONTARIO PERSONAL PROPERTY SECURITY ACT

*Including*

*Regulations under the Act;*
*the Repair and Storage Liens Act and Regulations;*
*the Electronic Registration Act (Ministry of Consumer and Business Services Statutes), 1991 and Regulation;*
*the Securities Transfer Act, and selected sections from Related Statutes and Regulations*

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*STATUTES OF ONTARIO ANNOTATED*

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# TAB 5

2010 ONSC 2101
Ontario Superior Court of Justice

Bank of Nova Scotia v. IPS Invoice Payment System Corp.

2010 CarswellOnt 2491, 2010 ONSC 2101, 101 O.R. (3d) 352, 17 P.P.S.A.C. (3d) 99, 188 A.C.W.S. (3d) 553, 318 D.L.R. (4th) 751, 67 C.B.R. (5th) 274

# Bank of Nova Scotia (Applicant) and IPS Invoice Payment System Corporations and Integrated Business Concepts Inc. (Respondents)

A. Karakatsanis J.

Heard: March 15, 2010
Judgment: April 9, 2010
Docket: 09-8439-CL

Counsel: Doug Bourassa for Applicant
Christopher Sparling for Respondent, IPS
Gerald Matlofsky for Respondent, IBC

Subject: Corporate and Commercial; Insolvency

**Related Abridgment Classifications**
For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

**Headnote**

**Personal property security --- Remedies — Miscellaneous**

Bank extended credit to debtor — IPS Corp. paid for interest in accounts receivable of debtor — Debtor obtained financing for specific inventory from IBC Inc., security for which was not registered — Funding from IBC Inc. was for production of specific inventory to be sold, for direct payment by purchaser — Bank issued notice of default and sought recovery of amounts collected by IPS Corp. and IBC Inc. — Bank brought application for order regarding its priority — Application granted — Bank had priority in amounts collected by IPS Corp. and IBC Inc. — Security agreement between bank and debtor covered money paid to debtor for assignment of accounts receivable and monies collected under assignment of receivables — Security agreement between bank and debtor required debtor to keep collateral free of encumbrances and did not allow for transfer of accounts receivables — Transfer of debtor rights not permitted by s. 39 of Personal Property Security Act — Proceeds were money paid by IPS Corp. to debtor for purchase of accounts receivable as well as collection on receivables from customers — Collateral can give rise to more than one set of proceeds — Recovery under s. 25 of Act is limited value of collateral at date of dealing.

**Personal property security --- Priority of security interest — Miscellaneous**

Bank extended credit to debtor — IPS Corp. paid for interest in accounts receivable of debtor — Debtor obtained financing for specific inventory from IBC Inc., security for which was not registered — Funding from IBC Inc. was for production of specific inventory to be sold, for direct payment by purchaser — Bank issued notice of default and sought recovery of amounts collected by IPS Corp. and IBC Inc. — Bank brought application for order regarding its priority — Application granted — Bank had priority in amounts collected by IPS Corp. and IBC Inc. — Recovery under s. 25 of Personal Property Security Act is limited value of collateral at date of dealing — Value of collateral was face value of receivables — Limiting recovery to value of receivable strikes balance between interests of parties and provides certainty in secured transactions — Bank was unaware of transfer of receivables or of bridge funding from IBC, and did not acquiesce to agreements — Debtor did not have implied license to deal with inventory in manner exempt from security agreement with bank.

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*Fairbanx Corp. v. Royal Bank* (2009), 2009 CarswellOnt 6098, 15 P.P.S.A.C. (3d) 265, 57 C.B.R. (5th) 310 (Ont. S.C.J.) — referred to

*GE Canada Equipment Financing G.P. v. ING Insurance Co. of Canada* (2009), [2009] I.L.R. I-4812, 70 C.C.L.I. (4th) 165, 51 C.B.R. (5th) 47, 308 D.L.R. (4th) 127, 248 O.A.C. 83, 2009 CarswellOnt 928, 2009 ONCA 171, 94 O.R. (3d) 321, 14 P.P.S.A.C. (3d) 49 (Ont. C.A.) — considered

*Rizzo & Rizzo Shoes Ltd., Re* (1998), 1998 CarswellOnt 1, 1998 CarswellOnt 2, 50 C.B.R. (3d) 163, [1998] 1 S.C.R. 27, 33 C.C.E.L. (2d) 173, 154 D.L.R. (4th) 193, 36 O.R. (3d) 418 (headnote only), (sub nom. *Rizzo & Rizzo Shoes Ltd. (Bankrupt), Re)* 221 N.R. 241, (sub nom. *Rizzo & Rizzo Shoes Ltd. (Bankrupt), Re)* 106 O.A.C. 1, (sub nom. *Adrien v. Ontario Ministry of Labour)* 98 C.L.L.C. 210-006 (S.C.C.) — followed

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*2811472 Canada Inc. v. Royal Bank* (2006), 23 C.B.R. (5th) 124, 81 O.R. (3d) 721, 10 P.P.S.A.C. (3d) 41, 2006 CarswellOnt 4200 (Ont. S.C.J.) — referred to

*2811472 Canada Inc. v. Royal Bank* (2007), 31 C.B.R. (5th) 142, 11 P.P.S.A.C. (3d) 158, 2007 CarswellOnt 1335, 85 O.R. (3d) 490, 2007 ONCA 150 (Ont. C.A.) — referred to

**Statutes considered:**

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s. 64(1) — considered

*Personal Property Security Act*, R.S.A. 2000, c. P-7

 

s. 28(1) — referred to

*Personal Property Security Act*, R.S.B.C. 1996, c. 359
s. 28(1) — referred to

*Personal Property Security Act*, R.S.M. 1987, c. P35
s. 28(1) — referred to

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s. 28(2) — referred to

*Personal Property Security Act*, S.N. 1998, c. P-7.1
s. 29(1) — referred to

*Personal Property Security Act*, S.N.S. 1995-96, c. 13
s. 29(2) — referred to

*Personal Property Security Act*, R.S.O. 1990, c. P.10
Generally — referred to

s. 1(1) "goods" — considered

s. 1(1) "proceeds" c) — considered

s. 1(1) "security interest" — considered

s. 2(b) — considered

s. 20(1) — referred to

s. 20(3) — referred to

s. 25 — considered

s. 25(1) — considered

s. 30(1) — considered

s. 33 — referred to

s. 39 — referred to

*Personal Property Security Act*, R.S.P.E.I. 1988, c. P-3.1
s. 28(1) — referred to

*Personal Property Security Act, 1993*, S.S. 1993, c. P-6.2
s. 28(1) — referred to

**Words and phrases considered:**

**collateral**

Collateral can give rise to more than one set of proceeds. There is no reason to limit recovery to the proceeds under the factoring agreement in light of the clear language of s. 25 [ of *Personal Property Security Act* R.S.O. 1990, c. P.10 ]. The definition of proceeds in the PPSA is sufficiently broad to cover both the monies paid by the factor to the debtor Blooming Rose for the absolute assignment of the receivables and the monies collected by the factor from the customers pursuant to those receivables.

APPLICATION by bank for declaration of priority of interest under *Personal Property Security Act.*

***A. Karakatsanis J.*:**

1 The Bank of Nova Scotia seeks a declaration that the proceeds collected by each of the respondents from accounts receivable of 1429030 Ontario Inc (Blooming Rose) are subject to the Bank's prior ranking security interest in Blooming Rose's receivables. The respondents collected proceeds from the receivables directly from Blooming Rose's customers. The Bank seeks judgment against IPS Invoice Payment System Corporations (IPS) in the amount of $442,698.01 and US$33,193.95; and against Integrated Business Concepts Inc. (IBC) in the amount of $216,033.02 up to a total amount of Blooming Rose's indebtedness to the Bank of $442,698.01 and US$33,193.95 (plus interest and costs).

2 The legal issue in this application is the interpretation of s. 25 of the *Personal Property Security Act*, R.S.O. 1990 c. P.10 (the "PPSA"): whether a secured party can enforce its security against both the original collateral and the proceeds of that collateral in an amount that exceeds the value of the original collateral. Put differently, the issue is whether the amount secured by the security interest in both the collateral and the proceeds is limited to the amount of the secured debt or the value of the collateral. This issue has not been addressed by any court in Ontario.

3 The factual issues in this application are whether the undisputed facts give rise to an inference that the Bank acquiesced or waived its rights.

**Background Facts**

4 The following facts are uncontroverted. Pursuant to a commitment letter in August 2008, the Bank extended credit facilities to Blooming Rose, including a revolving line of credit, margined against inventory and accounts receivable and secured by a prior general security agreement (GSA) dated February 2007. The Bank perfected its security interest in the property and assets, including the accounts receivables, of Blooming Rose pursuant to the PPSA by registering a financing statement in March 2007. The GSA provides that all amounts received by Blooming Rose from account debtors are to be held in trust for the Bank.

***The Factoring Arrangement with IPS***

5 In September 2007, Blooming Rose signed a factoring agreement with IPS. Blooming Rose absolutely assigned each invoice to IPS, with no right of redemption. Pursuant to the factoring agreement Blooming Rose agreed to repurchase any account which IPS was unable to collect (recourse obligation) and granted to IPS a security interest in all accounts receivable (whether purchased or not purchased) to secure the repayment of the recourse obligations.

6 IPS registered a financing statement perfecting its security interest in Blooming Rose's accounts receivables in September 2007, subsequent to the Bank's registration. IPS concedes it was aware of the Bank's security interest from the outset of its relationship as a result of its PPSA search and Blooming Rose's disclosure that its accounts receivable were pledged as collateral to the Bank.

7 IPS advanced monies during the period between September 2007 and December 2008 in return for the absolute assignment of the receivables. Cheques totalling $1.7 million were deposited to Blooming Rose's account with the BNS (in reduction of the indebtedness to BNS) with the name of "IPS Invoice Payment System Corp" evident as the payor. IPS advanced approximately $100,000 more than IPS collected on the accounts receivables.

 

8 The Bank claims that it first learned that Blooming Rose was factoring its accounts receivable with IPS in January 2009 at an account meeting with Blooming Rose. The Bank issued a notice of default, sought payment and ultimately the appointment of an interim receiver. The Bank seeks recovery of the amounts collected by IPS from customers to the full amount of the outstanding indebtedness of Blooming Rose.

9 IPS does not dispute that the factoring agreement is subject to the PPSA or the prior registration of the Bank's GSA. However, it claims that as a purchaser of the accounts, pursuant to s. 25 of the PPSA, the proceeds from the sale of collateral were the amounts paid by IPS to Blooming Rose for the purchase of those accounts and that those proceeds were paid to BNS to reduce its indebtedness. IPS submits that the Bank would be receiving double recovery if it was entitled to claim security in both the proceeds of the sale of the collateral, as well as the further proceeds from the collections from the collateral. IPS takes the position that the factoring agreement was not prohibited by the Bank's GSA or by the PPSA but that, in any event, IPS advanced $100,000 more than it collected and therefore BNS' security interest was not prejudiced under s. 39 of the PPSA.

***Seasonal Bridge Financing by IBC for Specific Inventory***

10 Blooming Rose required financing on a seasonal basis to fund the cost of inventory leading up to its busy December sales. In 2006 and 2007 it obtained seasonal bridge financing from IBC. Between July and November 2008, IBC advanced a total of $380,000 to Blooming Rose in four separate cheques on condition that the funds be used to produce specific inventory for sale to Wal-Mart and Zellers and that it be repaid directly by the customer. IBC regularly monitored production of the inventory. At Blooming Rose's direction, Wal-Mart subsequently paid $216,033.02 directly to IBC in payment for the inventory.

11 IBC was not aware of the Bank's GSA or of IPS' security interest in receivables, did not conduct a PPSA search and did not register its interest in the specific inventory pursuant to the PPSA. It obtained personal guarantees and other security for its loan.

12 The Bank seeks recovery of the amounts received directly from Wal-Mart provided the Bank does not recover more than the outstanding debt secured by the GSA. IBC takes the position that BNS granted an implied license to Blooming Rose to deal with the inventory in the ordinary course of business and as a result, such a licence authorizes the "satisfaction of obligations that are immediately incidental to an actual sale of the inventory" to third parties: *Royal Bank v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411 (S.C.C.). IBC submits that because its transaction with Blooming Rose was tied to specific inventory, the Bank's security interest gives way to debts incurred in the ordinary course of business. Further it submits that the Bank had effective notice and knowledge of the relationship and acquiesced or waived its rights and that IBC acted to its detriment in advancing further funds after its first advance.

**IPS: Were the Receivables Collected by IPS Encumbered by BNS's Prior Ranking Security Interest?**

***The Factoring Agreement Is Subject to the PPSA***

13 IPS does not dispute that the factoring agreement is subject to the PPSA or the prior registration of the Bank's GSA. Section 2(b) of the PPSA provides that the Act applies to every transaction that in substance creates a security interest including a transfer of an account even though the transfer may not secure payment or performance of an obligation. "Security interest" is defined in s. 1(1) of the PPSA as an interest in personal property which includes the interest of a transferee of an account. Section 39 of the Act provides that rights of a debtor may be transferred despite a provision in the security agreement prohibiting transfer or declaring a transfer to be a default, but no transfer may prejudice the rights of the secured party under the security agreement. Factoring arrangements and the assignment of accounts receivable are subject to the PPSA. See *Fairbanx Corp. v. Royal Bank*, [2009] O.J. No. 4222 (Ont. S.C.J.); also *2811472 Canada Inc. v. Royal Bank*, [2006] O.J. No. 2790 (Ont. S.C.J.) aff'd [2007] O.J. No. 820 (Ont. C.A.). Section 30(1) provides that priority is determined by the order of registration. There is no dispute that the Bank's registered GSA takes priority over IPS' registered security agreement.

***The Bank did not authorize the factoring agreement***

14 I do not find that the Bank expressly or impliedly authorized the factoring agreement and thus the dealing with the collateral by Blooming Rose. IPS submits that the factoring agreement was not prohibited by the Bank's GSA or by the PPSA. However, the GSA provides that Blooming Rose is to defend title and keep the collateral free and clear of encumbrances; all amounts received by Blooming Rose from account debtors are to be held in trust for the Bank; default occurs when any collateral is or is about to be in danger of being placed in jeopardy. Further, s. 39 does not authorize the transfer of collateral. It has no bearing on the issue of whether the transfer was lawful; it provides some protection to the transferee in the event of an unauthorized transfer of the collateral.

***There Can Be More Than One Set of Proceeds as Defined by s. 25 of the PPSA***

15 Section 25 (1) provides:

> Where collateral gives rise to proceeds, the security interest therein,
>
> (a) continues as to the collateral, unless the secured party expressly or impliedly authorized the dealing with the collateral free of the secured interest; and
>
> (b) extends to the proceeds.

16 Proceeds is defined in the PPSA as:

> identifiable or traceable personal property in any form derived directly or indirectly from any dealing with collateral or the proceeds therefrom, and includes
>
> .....
>
> (c) Any payment made in total or partial discharge or redemption of an intangible, chattel paper, an instrument or investment property....

17 IPS submits that the proceeds in this case are the monies paid by IPS to Blooming Rose for the purchase of the accounts receivable and paid to the Bank to reduce the indebtedness to the Bank. The Bank takes the position that proceeds are the collection on factored receivables from the customers. I accept both propositions.

18 I find that the monies paid by IPS to Blooming Rose for the purchase of the accounts receivable are proceeds within the definition in s. 1 and for the purpose of s. 25 of the PPSA. This is consistent with both the language and spirit of the legislation and with the decision of the New Brunswick Court of Queen's Bench in *Royal Bank v. Canadian Commercial Corp.*, 2001 CarswellNB 387 (N.B. Q.B.) at para. 68. The court identified the amount paid by the factor to the debtor for the assignment of the accounts receivable as the proceeds of the sale of the collateral. However, the case provides little assistance on the issue of whether the security interest also extended to the receivables because the court also found that the bank had authorized the factoring of the receivables.

19 I also find that the security interest extends to the further proceeds collected by the factor on those assigned receivables. In *Acorn Partners* (S.C.J.), at paras. 25, 28; (C.A.) at para. 2, the court accepted that monies collected on factored receivables from the customers are proceeds within the meaning of the Act. In that case, the debtor had misled the factor advising that the accounts had not been pledged; in this case IPS was aware of the Bank's prior security interest. While it was not clear in *Acorn Partners* what happened to the proceeds paid by the factor to the debtor pursuant to the factoring agreement, in this case the funds advanced to Blooming Rose were paid to the Bank in reduction of the indebtedness.

20 Collateral can give rise to more than one set of proceeds. There is no reason to limit recovery to the proceeds under the factoring agreement in light of the clear language of s. 25. The definition of proceeds in the PPSA is sufficiently broad to cover both the monies paid by the factor to the debtor Blooming Rose for the absolute assignment of the receivables and the monies collected by the factor from the customers pursuant to those receivables. Clearly the purpose of s. 25 is to maintain the security over both the collateral and the proceeds where a secured party does not directly or indirectly authorize the factoring of the

 

account receivable. In addition, under a factoring agreement, the value of the receivables will have been discounted (for early payment and/or risk of non-recovery) and it would be unfair to the Bank to limit recovery to the proceeds under the factoring agreement. Moreover, following *Acorn Partners*, there is no reason to exclude the proceeds recovered by the factor pursuant to the receivables.

***Is recovery under s. 25 limited by the full amount of indebtedness or the value of the collateral?***

21 The more difficult issue is whether recovery of the proceeds pursuant to s. 25 is limited only by the full amount of the outstanding indebtedness secured by the GSA or whether it is also limited to the value of the collateral.

22 Counsel advised that there are no cases dealing with the interpretation of s. 25 of the PPSA. While the section provides that the secured creditor can enforce against both the proceeds and the original collateral if certain conditions are satisfied, it does not impose any express limitation on the right to recovery. Obviously, some limitation is implicit in the PPSA regime and the language of the section is sufficiently broad that it does not dictate or preclude either limitation. In my view, the nature and extent of the limitation on recovery arises from an interpretation of the purposes and scheme of the Act.

23 It is well established by the Supreme Court of Canada that a modern purposive approach to statutory interpretation requires that "words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament." Elmer Driedger in *Construction of Statutes* (2nd ed. 1983) at p. 87. See *Rizzo & Rizzo Shoes Ltd., Re*, [1998] 1 S.C.R. 27 (S.C.C.) at para. 21; *Bristol-Myers Squibb Co. v. Canada (Attorney General)*, [2005] 1 S.C.R. 533 (S.C.C.) at paras. 95-96.

24 The *Legislation Act, 2006*, S.O. 2006, c. 21, Sched. F, s. 64(1) further justifies a strong emphasis on a purposive approach: "An Act shall be interpreted as being remedial and shall be given such fair, large and liberal interpretation as best ensures the attainment of its objects."

25 Every province in Canada except Ontario has a provision in its PPSA limiting recovery to the value of the collateral on the date of dealing where a secured party enforces against both the collateral and the proceeds: R.S.A. 2000, c. P-7, s. 28(1); R.S.B.C. 1996, c. 359, s. 28(1); C.C.S.M. c. P35, s. 28(1); S.N.L. 1998, c. P-7.1, s. 29(1); S.N.B. 1993, c. P-7.1, s. 28(2); S.N.S. 1995-96, c. 13, s. 29(2); R.S.P.E.I. 1988, c. P-3.1, s. 28(1); and S.S. 1993, c. P-6.2, s. 28(1).

26 One policy rationale for this limitation was discussed by Prof. Ronald Cumming in the *British Columbia Personal Property Security Act Handbook*, (Toronto: Carswell, 1998) at p. 185:

> The secured party made her bargain with the debtor on the assumption that she would be secured to the value of the original collateral. The secured party did not contemplate having recourse to the proceeds since she did not give the debtor the right to deal with the original collateral in such a way as to create proceeds. The qualifier in s. 28(1) prevents s. 28(1)(b) from producing an unexpected windfall for the secured party by turning unsecured debt into secured debt at the expense of the debtor or the unsecured creditors of the debtor.

27 In discussing the Ontario statute, Prof. Cumming, in *Personal Property Security Law* (Toronto: Irwin Law, 2005) at p. 461, noted that:

> The issue that has yet to be decided is whether the secured party will be able to proceed against the full value of both the original collateral and the proceeds, or whether a court will read into the statute a limitation similar to the one contained in the Acts of the other jurisdictions. The authors are of the opinion that such a limitation would be the most appropriate response. The basic premise behind the proceeds provisions is that the proceeds should stand in the place of the original collateral. Although a secured party has the right to claim both the original collateral and the proceeds where there has been a wrongful dealing by the debtor, this was intended to protect the secured party against a post-disposition deterioration in the value of the original collateral or the proceeds and was not intended to give an unexpected windfall to the secured party at the expense of the debtor or the unsecured creditors of the debtor.

  

28 In *The 2010 Annotated Ontario Personal Property Security Act* (Toronto: Thompson Canada, 2009) at p. 213, Prof. Richard McLaren states that, where a "secured party claims an interest in both the collateral and the proceeds, the secured party is limited to the amount secured." He does not, however, provide any analysis in support of that position.

29 The PPSA creates a notice and priority regime to provide protection to secured creditors and third parties, and to increase certainty and predictability in secured transactions. As noted by the Court of Appeal in *GE Canada Equipment Financing G.P. v. ING Insurance Co. of Canada*, 2009 ONCA 171 (Ont. C.A.) at para. 24:

> The PPSA is provincial chattel security legislation designed to protect the rights of creditors and debtors by regularizing secured transactions in personal property. To achieve this objective, the PPSA establishes a province-wide, notice-based registration system. ... The purpose of such legislation was described by Gonthier J. (dissenting on other grounds) in *Royal Bank of Canada v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411, at para. 21:
>
>> [P]rovincial legislatures have moved to protect secured creditors generally through the enactment of personal property security legislation ... These statutory regimes have been implemented to increase certainty and predictability in secured transactions through the creation of a coherent system of priorities ... The benefits of such certainty in commercial transactions, on basic economic principles, are intended to accrue to the health of the economy in general.

30 In addition, the PPSA provides protection and certainty to debtors to facilitate the use of personal property as collateral and to provide consistency and fairness in the enforcement of security interests: see *Saulnier (Receiver of) v. Saulnier*, [2008] 3 S.C.R. 166 (S.C.C.) at para. 19.

31 On the one hand, limiting recovery under s. 25 by the amount of the debt secured by the collateral is anchored in the terms of the security agreement between secured creditor and debtor and the prior registration. There is no requirement that the value of the collateral be limited to the amount of the debt being secured. Indeed, the value of the collateral may well exceed the value of the debt being secured. Furthermore, the secured party does not authorize the disposition of the collateral and therefore does not have the opportunity to decide whether to accept any risks arising from the dealing with the collateral, while a third party will be put on notice by prior registration to investigate the nature and extent of the existing security interest. Such an interpretation focuses only on the recovery of the secured party who has prior registration and the total debt secured by that registration, rather than upon the collateral or upon the rights of the third party.

32 On the other hand, an interpretation that limits recovery to the value of the receivable strikes a balance between the interests of the various parties, including the third party, and provides greater certainty and predictability in secured transactions. It gives the parties what they bargained for. Since the secured party only bargained for security over the value of the specific collateral, it should not be able to convert unsecured debt to secured debt simply because the collateral has been dealt with. While the Bank's priority should not be prejudiced by the transaction, there is no compelling reason why it should be able to recover a windfall - double recovery from the same collateral. As well, the structure of the notice regime in the PPSA provides a strong rationale for limiting recovery to the value of the collateral as of the date of dealing. A third party purchasing encumbered collateral will have no notice of the size of the debt secured, only of the fact that the collateral is subject to a prior security interest. To the extent the third party makes an error or chooses to risk a prior registered security interest, it is appropriate that they bear the risk of losing the collateral or the proceeds recovered if the amounts paid for the receivables are not paid to the secured creditor (in this case the Bank) and to the extent of any discount on the value of the receivables. However, sequential dealings with the collateral could generate more than one set of proceeds and create uncertainty with respect to the extent of a third party's liability. The focus of s. 25 is upon the collateral and the proceeds of dealing with the collateral. It provides the secured party with recourse to proceeds to ensure that any shortfall from the dealing with the assets can be remedied. Other provinces have made specific provision limiting recovery of the proceeds in such a way. Clearly such a principle is not generally destructive of a PPSA regime.

33 For these reasons, I find that recovery under s. 25 of the PPSA is limited to the value of the collateral on the date of dealing. While an argument could be made that market value of the collateral as of the date of dealing should include a discount

 

for pre-payment or the risk of non-recovery, it seems to me inappropriate to have the secured party pay for a discount that it did not authorize. In any event, I do not have the evidence in this case to determine the market value of the receivables based upon the age of the receivables or the risk relating to collection. IPS could have sought the consent of the Bank but did not do so despite its notice of the Bank's prior perfected interest. Any risk associated with the collateral should be borne by the factor in these circumstances, rather than the Bank. I find that, in this case, the value of the collateral is the face value of the receivable.

34 IPS advanced approximately $100,000 more than IPS collected. I do not agree that as a result, the Bank suffered no loss. This is not a claim for damages but rather a claim for priority and for proceeds under the PPSA regime.

35 Based upon the IPS affidavit material, IPS advanced a percentage of the face value of the receivables and retained fees. IPS advises that it purchased invoices with a face value of $1,229,883.43 and US$554,854. IPS advanced to Blooming Rose and deposited with the Bank the sum of $1,118,620.98 and US$517,708.60. The difference representing the discount and fees appears to be $111,262.45 and US$37,145. However, if these numbers do not give effect to the principle that the Bank should recover the full face value of the receivables, to the extent it is greater than the monies IPS paid for the receivables and deposited to BNS, the parties may make brief written submissions with respect to the amount of the judgement (within 10 days.)

**IPS: Waiver or Acquiescence**

36 IPS submits that BNS knew that Blooming Rose was factoring its accounts to IPS since cheques totalling $1.7 million were deposited to Blooming Rose's account with the BNS (in reduction of the indebtedness to BNS) during the period between September 2007 to December 2008. The name of "IPS Invoice Payment System Corp" was clearly marked as the payor and it would have been readily apparent that IPS was not an account debtor or customer. It submits that given its constructive notice of the deposit of the cheques, the Bank permitted the continued and regular purchase of accounts and that BNS waived or acquiesced in the factoring.

37 The evidence is that BNS did not know who the payor was and did not see copies of the cheques: the cheques were managed by Simcor, a third party, who did not provide copies of the cheques unless requested and BNS did not make any such request. The Bank's evidence is that it demanded that the factoring cease as soon as it became aware in January 2009 as a result of the annual review. I accept the evidence that the Bank was unaware of the factoring prior to its meeting with Blooming Rose in January 2009. While the affiant did not have extensive personal knowledge, he was the current manager of the account and informed himself from speaking to the account manager and from the Bank's file, including the report of the January meeting. The monthly reports from Blooming Rose reported its outstanding receivables to the Bank without reference to the fact that they had been assigned to IPS. These facts do not support a finding that BNS was aware of the factoring prior to January 2009.

38 While IPS submits that Simcor's knowledge as an agent for the Bank resulted in constructive notice to the BNS that cheques were from IPS Invoice Payment System Corp, I am not satisfied that even constructive knowledge of the payor of the cheques would support the inference that the Bank had knowledge that Blooming Rose was factoring its receivables with IPS or that as a result it did not intend to rely upon its legal rights. I do not find that these facts alone are capable of establishing waiver or estoppel. Such a finding would impose a positive obligation on a bank to conduct detailed reviews of the cheques and further investigation in order to protect its security interest; this is neither required by law nor justified under commercial practice: see *Roclar Leasing Ltd. v. MacMillan Bloedel Ltd.*, [1988] O.J. No. 162 (Ont. H.C.) para. 34.

**IBC: Waiver, Acquiescence, Estoppel**

39 IBC had assisted Blooming Rose with loans in 2006 and 2007. Due to the seasonal nature of its business, Blooming Rose needed financing in the latter half of the year because of the ramp up to its Christmas sales. In the summer and fall of 2008 IBC provided financing for the purchase of specific inventory that was to be sold to Wal-Mart. IBC made it a condition of advancing funds that the funds advanced would be earmarked to produce the material that would be supplied to Wal-Mart and that Blooming Rose would direct payments to IBC upon their sale.

40 IBC submits that BNS had notice of IBC's involvement with Blooming Rose and acquiesced to the relationship. It submits the Bank's notice was based on the following:

 

The June 30, 2006 and June 30, 2007 financial statements of Blooming Rose showed loans payable of $108,663 and $306,099 respectively;

Blooming Rose advised the BNS that it would require bridge financing from other sources if the Bank did not finance its orders for Wal-Mart;

The IBC cheques deposited to the BNS account: July 2- $70,000; August 6- $60,000; September 17- $190,000; and November 18- $60,000; and

Blooming Rose's monthly accounts payable summaries for March, April and May 2007 cite amounts owing to IBC of $3000 to $6000.

41 IBC therefore argues that: given the Bank would have been aware of a debt relationship prior to providing the credit facility; given its knowledge that seasonal bridge financing was required; given the size and round numbers of the IBC cheques and the fact that the cheques were noted as "loan proceeds" or "conditional loan proceeds;" and given the discrepancies between the size of the cheques and the amounts noted on the monthly accounts payable summaries, and the fact that the Bank monitored cash flow and profit margins, the Bank had constructive knowledge that IBC was providing inventory financing. IBC submits that these circumstances should have at least raised a suspicion that it was receiving funds that were not from a trade creditor and that the Bank was therefore wilfully blind or negligent in not following up as to the nature of the large deposits. The position of IBC is that the Bank had the means of knowledge, the information, the monitoring resources and the manpower to obtain knowledge and it benefited from IBC's activity.

42 However, Blooming Rose did not disclose any indebtedness to IBC when it applied for financing in 2007. Furthermore, the financial statements did not identify the loans payable as owing to IBC. The payables disclosed relatively small amounts owing to IBC. The Bank did not see the cheques or request them. Although this account was subject to a pilot project with various risk triggers, no activity in this account generated significant transactions reports. To impute knowledge to the bank in these circumstances would effectively require the bank to maintain a very high standard of review and investigation in order to protect its registered security interest. This is not required by the legislation or the case law and is not in my view commercially reasonable. The PPSA provides for registration in order to provide clear notice and to determine priority.

**IBC: Licence to Sell**

43 I am satisfied the loan from IBC was made for the production of the specific inventory. IBC deposed that it advanced the funds on condition that they be earmarked for production of the specific inventory to be sold to Wal-Mart and on condition that it receive the payment for the inventory directly from Wal-Mart. Although the deponent for IBC testified that they had no specific mechanism to ensure that the advance was used for the production of inventory, he deposed that they had "regular monitoring" and that further the inventory was produced, sold to Wal-Mart and they paid for it. IBC applied the payment from Wal-Mart in repayment of the loan to Blooming Rose.

44 IBC submits that BNS granted an implied license to Blooming Rose to deal with the inventory and therefore the GSA does not apply to the accounts receivable IBC collected from Wal-Mart. In *Royal Bank v. Sparrow Electric Corp.*, above, the Supreme Court of Canada held that a license to sell inventory authorizes the satisfaction of obligations that are immediately incidental to the actual sale of the inventory.

45 I am not persuaded that there is evidence that the Bank granted an implied licence to Blooming Rose to deal with inventory in such a fashion. The evidence relied upon, above, for waiver or acquiescence does not support an inference of a licence to sell. Section 28 of the PPSA provides for an exception for a purchaser of goods in the ordinary course of business. However, accounts are not tangible personal property and therefore do not fall within the meaning of 'goods' as defined in s. 1 of the PPSA.

46 In the absence of registration and notice, IBC cannot assert priority for inventory financing under the PPSA. According to ss. 20(1), 20(3), and 33, a PMSI will only obtain superiority where it is perfected by registration. IBC's interest is unperfected

  

and is therefore subordinate to any other perfected security interest. Accordingly, IBC's security interest is subordinate to the interests of both BNS and IPS.

47 For all these reasons, the monies IBC received from Wal-Mart are subject to the Bank's prior ranking security interest and the Bank should have judgment in the amount collected, subject to the full amount of the debt outstanding.

**Decision**

48 For these reasons, accounts receivable of 1429030 Ontario Inc (Blooming Rose) collected by each of the respondents, directly from customers of Blooming Rose were subject to the Bank's prior ranking security interest in Blooming Rose's receivables.

49 The Bank shall have judgment against IPS Invoice Payment System Corporations (IPS) in the amount of $111,262.45 and the Canadian dollar equivalent of US$37,145 (representing the discounted portion of the receivables). The Bank shall have judgment against Integrated Business Concepts Inc. (IBC) in the amount of $216,033.02. These amounts do not exceed the total amount of Blooming Rose's indebtedness to the Bank of $442,698.01 and the Canadian dollar equivalent of US $33,193.95 (plus interest and costs). These amounts do not result in recovery of proceeds that exceed the face value of the receivables.

50 If the parties cannot agree, brief written costs submissions may be filed within 21 days. Any replies within 10 further days.

*Application granted.*

End of Document



 

# TAB 6

2003 SCC 66, 2003 CSC 66
Supreme Court of Canada

National Trust Co. v. H & R Block Canada Inc.

2003 CarswellOnt 4443, 2003 CarswellOnt 4444, 2003 SCC 66, 2003 CSC 66, [2003] 3 S.C.R. 160, [2003] S.C.J. No. 70, 126 A.C.W.S. (3d) 876, 14 R.P.R. (4th) 1, 180 O.A.C. 1, 232 D.L.R. (4th) 193, 312 N.R. 91, 38 B.L.R. (3d) 1, 44 C.B.R. (4th) 249, 68 O.R. (3d) 800 (note), 68 O.R. (3d) 800, J.E. 2003-2167, REJB 2003-49827

# H & R Block Canada Inc., Appellant v. National Trust Co., Respondent

Iacobucci, Major, Bastarache, Binnie, Arbour, LeBel, Deschamps JJ.

Heard: June 3, 2003
Judgment: November 14, 2003 *
Docket: 28975

Proceedings: reversing (2001), 2001 CarswellOnt 3682, 151 O.A.C. 82, 56 O.R. (3d) 188, 28 C.B.R. (4th) 251, 18 B.L.R. (3d) 172, 207 D.L.R. (4th) 147, 46 R.P.R. (3d) 182 (Ont. C.A.)

Counsel: Samuel R. Rickett, Michael J.W. Round for Appellant
David J.T. Mungovan, Peter J. Cavanagh for Respondent

Subject: Corporate and Commercial; Insolvency

**Related Abridgment Classifications**
For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

**Headnote**

**Bulk sales --- Effect of non-compliance with Act — General**

Buyer H&R of stock in bulk from T Ltd. was not liable for damages to unsecured creditor of T Ltd. under duty to account of s. 16(2) of Bulk Sales Act — Requiring buyer to pay twice would be unfair, as secured creditors had been paid from proceeds of sale — Unsecured creditor was not entitled to windfall — Equitable accounting required that creditor was due only what he might have recovered if buyer had complied with Act — Bulk Sales Act was not intended to be punitive in nature.

**Vente en bloc --- Conséquences de la non-conformité avec les exigences de la Loi — En général**

H&R, qui avait acheté en bloc des biens de T ltée, ne pouvait être tenue responsable, en vertu de l'obligation de rendre compte prévue à l'art. 16(2) de la Loi sur la vente en bloc, pour le préjudice causé au créancier non garanti de T ltée — Comme les créanciers garantis avaient été payés avec le produit de la vente, il serait injuste d'exiger de l'acheteur qu'il paie deux fois — Créancier non garanti n'avait aucun droit à une rentrée de fonds inattendue — Selon la reddition de compte fondée sur l'équité, un créancier n'a droit de recouvrer que ce qu'il aurait pu obtenir si l'acheteur s'était conformé à la Loi — Loi sur la vente en bloc n'a pas un caractère punitif.

In 1991, H&R purchased stock in bulk from T Ltd. H&R failed to comply with s. 4 of the Bulk Sales Act. Instead, it accepted T Ltd.'s promise that it would be indemnified for any liability incurred resulting from non-compliance with the Act. T Ltd. used the entire proceeds of the sale to pay secured creditors. Prior to the sale, T Ltd. had commenced an action against a trust company for damages for breach of trust and breach of fiduciary duty. The trust company had counterclaimed for unpaid loans. T Ltd.'s action was dismissed in 1993 and the trust company was awarded judgment on its counterclaim. The trust company brought proceedings under s. 17(1) of the Act for an order declaring the bulk sale void as a result of

H&R's non-compliance with s. 4 of the Act and for an order requiring H&R to account to it under s. 16(2) of the Act for the amount which it claimed it was owed by T Ltd. as of the time of the 1993 judgment. The application was granted. H&R's appeal was dismissed. A majority of the court of appeal upheld the decision of the trial judge, on the grounds that a unilateral decision by T Ltd. as to how to distribute the proceeds of the sale was not a proper accounting for the value of the stock in bulk. H&R appealed.

**Held:** The appeal was allowed.

Per Bastarache J. (Arbour, Binnie, Iacobucci, Major JJ. concurring): The primary purpose of the Bulk Sales Act is to protect the interests of all creditors, secured and unsecured alike, whose debtors have disposed of all or substantially all of their assets. The Act also ensures the fair distribution of the proceeds of a sale in bulk; specifically, that the creditors of a seller receive their ratable share of the proceeds of the sale in bulk based on priority ranking and are not prejudiced by the sale.

A purposive approach to the interpretation of the buyer's duty to account under s. 16(2) of the Act, after having failed to comply with the Act, required that the buyer pay to the seller's creditors the amount that the creditors were deprived of as a result of the non-compliant sale. The Act reflects a desire to deter fraud and to ensure that creditors are properly paid. There is, however, no legislative intent to punish non-compliant buyers in cases where there has been proper payment to the seller's creditors, whether that payment was made by the buyer or the seller. H&R, as buyer, did not comply with the provisions of the Act, and, as such, the sale in bulk from T Ltd. was declared void under s. 16(1). H&R's duty to account required that it pay to the seller's creditors the amount they were deprived of as a result of the non-compliant sale. The trust company was not placed at a disadvantage by T Ltd.'s payments to its two highest-ranking creditors. It would be very unfair to require H&R to now pay the trust company the value of the proceeds of the sale, thus placing it in a better position than it would have been in had the requirements of the Act been met. The trust company was not entitled to damages under the s. 16(2) duty to account.

Deschamps J. (dissenting) (LeBel J. concurring): The issue was not what would have happened if the law had been obeyed, but rather how to apply the requirements of s. 16(2) of the Bulk Sales Act so that it was consistent with the objectives and spirit of the Act. The general objective of the Act was to improve the position of creditors when debtors sold their businesses. Three mutually complementary mechanisms, reinforced by a sanction, operated to achieve this general objective. The sanction provided in s. 16(2) of requiring the buyer to account to the creditors for the value of the property was essential to the proper operation of the Act. Under this provision, the buyer was liable to account for the value of the stock in bulk, and not for the value of the proceeds of sale. An interpretation based on the use of the proceeds of sale to pay the secured creditors would undermine the spirit of the Act, which was intended to protect ordinary creditors as well as secured creditors. An interpretation that eliminated the consequences of violating the Act would be an implicit repeal of the Act. The law did not provide for a windfall. The Act simply set out the consequences of the commercial risk that the buyer and seller take when they fail to comply with one of its provisions. It was not obvious that H&R would have to pay twice, because T Ltd. and its president had undertaken to indemnify them. After the sale was declared void, the duty to account for the property was automatic. The appeal should be dismissed.

H&R a acheté des biens en bloc de T ltée en 1991. H&R n'a pas respecté les formalités de l'art. 4 de la Loi sur la vente en bloc. Elle a plutôt accepté la promesse de T ltée selon laquelle elle serait dédommagée advenant qu'elle soit tenue responsable en raison du non-respect de la Loi. T ltée a payé ses créanciers garantis avec l'ensemble du produit de la vente. T ltée avait intenté, avant la vente, une action en dommages contre une compagnie de fiducie pour abus de confiance et manquement à son obligation fiduciaire. La compagnie de fiducie avait présenté une demande reconventionnelle relativement à des prêts non remboursés. L'action de T ltée a été rejetée en 1993, et la compagnie de fiducie a obtenu un jugement favorable à l'égard de sa demande reconventionnelle. La compagnie de fiducie a intenté un recours en vertu de l'art. 17(1) de la Loi, afin d'obtenir une ordonnance annulant la vente en bloc pour non-respect de l'art. 4 de la Loi, et une ordonnance exigeant que H&R lui rende des comptes, en vertu de l'art. 16(2), relativement au montant qu'elle alléguait lui être dû par H&R au moment où le jugement a été prononcé en 1993. La demande a été accueillie. Le pourvoi de H&R

 

a été rejeté. La Cour d'appel a confirmé à la majorité la décision du juge de première instance au motif que la décision unilatérale de T ltée quant à la répartition du produit de la vente n'était pas la manière appropriée de rendre compte de la valeur des biens en bloc. H&R a interjeté appel.

**Arrêt:** Le pourvoi a été accueilli.

Bastarache, J. (Iacobucci, Major, Binnie, Arbour, JJ., souscrivant): L'objectif premier de la Loi sur la vente en bloc est de protéger les intérêts de tous les créanciers, garantis ou non garantis, dont les débiteurs se sont départis en totalité ou presque de leurs actifs. La Loi assure également la distribution équitable du produit de la vente en bloc; plus particulièrement, elle assure que les créanciers du vendeur reçoivent leur part du produit de la vente en bloc en fonction de leur rang de collocation et qu'ils ne soient pas lésés par la vente.

L'interprétation téléologique de l'obligation de rendre compte de l'acheteur en vertu de l'art. 16(2) de la Loi fait ressortir que la Loi oblige l'acheteur qui ne s'est pas conformé à la Loi à verser aux créanciers du vendeur la somme dont ils ont été privés en raison de la non-conformité de la vente. La Loi reflète la volonté de dissuader les fraudes et d'assurer que les créanciers sont payés comme il se doit. Le législateur n'avait cependant pas l'intention de punir les acheteurs qui ne se sont pas conformés à la Loi dans le cas où les créanciers du vendeur ont été payés, que le paiement ait été fait par l'acheteur ou par le vendeur. À titre d'acheteur, H&R ne s'est pas conformée aux dispositions de la Loi et, ce faisant, la vente en bloc a été annulée en vertu de l'art. 16(1). L'obligation de rendre compte de H&R exigeait qu'elle verse aux créanciers les montants dont ils ont été privés en raison de la vente non conforme. La compagnie de fiducie n'était pas désavantagée par les versements faits par T ltée à ses deux créanciers de niveau supérieur. Il serait injuste d'exiger de H&R qu'elle verse à la compagnie de fiducie une portion du produit de la vente, mettant ainsi celle-ci dans une meilleure position que si les exigences de la Loi avaient été respectées. La compagnie de fiducie n'avait droit à aucun dommage en vertu de l'obligation de rendre de compte de l'art. 16(2).

Deschamps, J. (dissidente) (LeBel, J., souscrivant): Il ne s'agissait pas de se demander ce qui serait arrivé si la Loi avait été respectée, mais plutôt de se demander de quelle manière il fallait appliquer les exigences de l'art. 16(2) de la Loi sur la vente en bloc afin de se conformer aux objectifs et à l'esprit de la Loi. La Loi visait généralement à améliorer le sort des créanciers lorsque leurs débiteurs vendent leur entreprise. On utilisait trois mécanismes complémentaires et une sanction pour atteindre cet objectif général. La sanction prévue par l'art. 16(2), qui obligeait l'acheteur à rendre compte aux créanciers de la valeur des biens, était essentielle au bon fonctionnement de la Loi. Selon cette disposition, l'acheteur était tenu de rendre compte de la valeur des biens achetés en bloc, et non tenu de rendre compte de la valeur du produit de la vente. Interpréter la Loi en fonction du fait que le produit de la vente avait été utilisé pour payer les créanciers garantis aurait pour effet de miner l'esprit de la Loi, laquelle visait à protéger tant les créanciers ordinaires que garantis. Une interprétation qui éliminerait les conséquences résultant de la contravention à la Loi constituerait une abrogation implicite de celle-ci. L'application de la Loi ne constituait pas un cadeau du ciel. La Loi énonçait clairement quelles étaient les conséquences du risque commercial pris par le vendeur et l'acheteur en ne respectant pas les dispositions de la Loi. Il n'apparaissait pas clair que H&R aurait eu à payer deux fois, T ltée et son président s'étant engagés à la dédommager. L'obligation de rendre compte s'appliquait automatiquement dès l'annulation de la vente. Le pourvoi devrait être rejeté.

## Annotation

The decision in *National Trust Co. v. H & R Block Canada Inc.*, 2003 CarswellOnt 4443, 2003 CarswellOnt 4444, 44 C.B.R. (4th) 249, 38 B.L.R. (3d) 1, 14 R.P.R. (4th) 1 (S.C.C.), is not strictly a real property case, but bulk sales issues have an indirect impact on almost all Ontario real property transactions. Moreover, the direction that the Supreme Court of Canada has taken in *National Trust* may ultimately prove influential in a number of legal issues outside of just bulk sales *per se*, with the possibility of influencing directly a number of juridical concepts unique to real property.

The issue in *National Trust* is very simple and the facts largely undisputed. A vendor sold, and a purchaser purchased, assets in bulk without compliance with the *Bulk Sales Act*, R.S.O. 1990, c. B.14 (the "Act"). An unsecured creditor of the vendor objected and demanded that the sale be voided and that the purchaser be ordered to account to the unsecured creditor by paying to the unsecured creditor the value of the assets acquired in the bulk sale transaction. The prospect of "double payment" for the assets faced by the purchaser was consistent with the literal wording of the Act and, indeed, was precisely how the Act was ordinarily intended to operate. What made *National Trust* anything but a textbook application of the Act was the fact that the proceeds from the bulk sale were paid to the vendor's senior ranking secured creditor, and even then there remained a deficiency on the senior secured debt. In other words, had the secured creditors exercised their various sale remedies in the ordinary course (in lieu of a sale in bulk by the debtor), the senior secured creditor would have realized all of the value of the assets sold in bulk, and nothing would have been left for either the junior secured creditor or for any of the unsecured trade creditors. In effect, strict compliance with the Act would have resulted in a windfall for the subordinate creditors, since they would have recovered in full as if they were prior ranking secured creditors.

This unjust enrichment of the unsecured creditor is exactly the outcome that was sanctioned by both levels of the Ontario Court of Justice: first by Mr. Justice Spence of the Ontario Court of Justice General Division (November 6, 1997), Doc. B343/95 (Ont. Gen. Div.); and then by a split decision of the Ontario Court of Appeal (2001), 2001 CarswellOnt 3682, 56 O.R. (3d) 188, 28 C.B.R. (4th) 251, 18 B.L.R. (3d) 172, 46 R.P.R. (3d) 182 (Ont. C.A.), (per Macpherson J.A., with McMurtry C.J.O. concurring, and a vigorous, and ultimately vindicated, dissent by Mr. Justice Borins). Indeed, the Ontario jurisprudence has typically been unkind to purchasers who would ignore the Act. Even prior to *National Trust*, the Ontario Court of Appeal decision in *Sidaplex-Plastic Suppliers Inc. v. Elta Group Inc.* (1998), 1998 CarswellOnt 2819, 40 O.R. (3d) 563, 43 B.L.R. (2d) 155 (Ont. C.A.), relied on in the trial decision in *National Trust*, stood for the proposition that a court should adopt a strict liability interpretation of the Act when voiding a bulk sale. *Sidaplex* left little room under *stare decisis* for subsequent Ontario courts to "purposively" interpret the remedial provisions of the Act once substantive non-compliance with the Act had been established.

A divided Supreme Court of Canada bench reversed the Ontario position in *Sidaplex* and *National Trust* and adopted, instead, the "purposive approach" to statutory construction (as opposed to the "strict approach" favoured by the Ontario courts). The reasons delivered by Mr. Justice Bastarache for the Supreme Court majority (with Iacobucci, Major, Binnie and Arbour, JJ. concurring), greatly paraphrased, are as follows:

(i) the Act was never intended to be punitive, and to require the purchaser to pay out the unsecured creditor under such circumstances would have been *de facto* punitive;

(ii) there is a strong policy bias in Canadian transactional business law in favour of commercial efficacy, and legislation should be interpreted as much as possible to accommodate commercial reality; and

(iii) the purpose of the Act was to protect unsecured creditors against fraudulently conveying debtors, but not to afford unsecured creditors windfalls in circumstances where realization by existing secured creditors would ordinarily have yielded no recovery whatsoever for unsecured creditors.

The majority reasons in *National Trust* give rise to a number of observations. For instance, the Court's first contention, that the Act is not meant to be punitive, is not entirely intuitive. There is a great deal of legislation still on the books in common law jurisdictions that contain remedial provisions that are clearly more than compensatory in nature (*e.g.*, the double rent for overholding under the *Commercial Tenancies Act*, R.S.O. 1990, c. L.7, and the treble damages rule under the U.S. *Sherman Act*, 15 U.S.C. §§1-7). This is especially true of legislation with historical roots from about the same time as the height of the wave of bulk sales legislation (*circa* the turn of the twentieth century). Nor is the punitive nature of these Acts disguised. In *Sidaplex*, Mr. Justice Rosenberg expressly referred to the purchaser's double payment burden under the Act as " . . . a *penalty* that the purchaser must pay if the sale proceeds are not used to pay the creditors . . . [emphasis added]".

 

Indeed, an argument could be made that this type of commercial legislation really has to be punitive to some extent in order to serve as an effective disincentive against breach. In some cases, the absence of a clear punitive remedy appears to invite breach as a matter of course. So, for instance, anecdotal evidence suggests that, in many "credit proofing" schemes that are ultimately found to be fraudulent conveyances under the *Fraudulent Conveyances Act*, R.S.O. 1990, c. F.29, the vendors fraudulently diverted their assets to avoid their creditors on the belief that, even if caught, the *Fraudulent Conveyances Act* is not punitive, and the "worst case scenario" would simply be a return of the diverted assets. While such assets would then again be in harm's way, that was, in any event, the *status quo* prior to diversion, so there is no effective "downside" risk. Ironically, although this is technically correct, it does not ultimately ring entirely true in the case of the *Fraudulent Conveyances Act*, since it is frequently overlooked that fraudulent conveyance is not just a civil infraction, but also a crime under the *Criminal Code*, R.S.C. 1985, c. C-46 (wherein lies a truly punitive remedy — incarceration). It may very well be that the Act, which is closely aligned in purpose and history with the *Fraudulent Conveyances Act*, may in fact have been intended by the legislature to have remedies which could in fact be punitive. This annotation does not advocate one argument over the other, but if the Act was intended to be at least potentially punitive, then it is also arguable that it should have been within the providence of the legislature (and not that of a court exercising "purposive" construction) to change the Act's punitive characteristics.

While it is difficult for any practising solicitor to say much about a "motherhood" statement like the Supreme Court's policy imperative to "facilitate economically-efficient transactions", it is nonetheless one of those judicial directives that this annotator finds actually quite difficult to apply. There is nothing in the reasoning that necessarily demands that the *ratio* in *National Trust* be strictly constrained to the Act itself or to the facts in *National Trust*. Using a purely real property example, consider the differences between a quit claim deed given by a mortgagor to its mortgagee, and the longer and more expensive judicial foreclosure proceedings that such mortgagee could bring against the mortgagor in order to vest itself with title to the mortgaged property. There is no doubt that the "deed-in-lieu" remedy is certainly the far more economically-efficient transaction, but it also has the unfortunate disadvantage of leaving all subordinate encumbrances in tact and binding upon successors in title (including the mortgagee taking under such deed-in-lieu). In contrast, a final order of foreclosure or a sale under power of sale typically cuts out all such subordinate encumbrances. Should or could *National Trust* be applied to bar subordinate encumbrancers under such circumstances from their respective claims when a mortgagor itself sells the mortgaged property (either to the mortgagee or to a third party with proceeds directed to the mortgagee), instead of allowing the mortgaged property to be foreclosed or sold under power of sale by the mortgagee in the ordinary course? After all, the subordinate encumbrancers would clearly have had no legal recovery whatsoever had the mortgagee bothered to formally foreclose or sell under power of sale (there is a presumption that, as in *National Trust*, the proceeds are insufficient to retire the mortgagee's secured debt). Should the mortgagee be required to endure the material delay and increases in legal and other transaction costs that would be required for a formal remedy, when the subordinate encumbrancers have no realistic hope of realizing any recovery? Indeed, an extrapolation of *National Trust* might suggest that, so long as it can be shown that realization against the assets cannot fully retire the highest ranking secured debt, then other creditors really should not have any "rights" at all, since compliance with such rights could only lead to economic inefficiencies. Is this "so long as it would not have made a difference" philosophy really the logical application of the *National Trust* decision? If so, the scope of legislation that may now be affected by this efficiency doctrine is considerable.

As aforesaid, the *National Trust* decision was split at the Supreme Court. The minority's critique of the majority reasons is best summarized in the following excellent passage from the written reasons of Deschamps J. (with Lebel J. concurring):

Participation by all classes of creditors, and more specifically by the ordinary creditor class, is circumvented, judicial review is evaded, and the parties have no incentive to comply with the Act because all that needs to be done in order for the buyer and seller to escape any sanction is to prove that the secured creditors have received an amount equal to the value of the proceeds . . . It is not the function of judges to substitute their judgment for the wills of the legislature or the parties simply to minimize the impact of commercial legislation that they believe to be cumbersome or unfair.

The dissenting reasons fail, however, to convincingly address the issue of the resulting windfall in favour of the unsecured creditor. In fact, the dissenting reasons conclude that the law did not in fact provide for a windfall at all, concluding, instead, that the result is simply "the consequence of the commercial risk that the buyer and seller take when they fail to comply with [the Act]". This conclusion is, respectfully, trite and nothing short of a "sidestepping" of the windfall issue altogether. It may be debated whether the Act should, as a matter of policy, be punitive in nature (it is clear that the operation of the Act, as validated by the Court of Appeal in *National Trust*, is in fact punitive, and attempts in the dissenting reason to suggest otherwise are not convincing). Furthermore, it might be questionable whether economic efficiency in business transactions is so laudable a policy objective as to warrant the outright exclusion of legal protocols and safeguards for other parties, even if ultimately futile. However, these policy concerns do not themselves explain why breach of the Act should then give rise to lottery-like winnings for the unsecured creditors. If indeed the unsecured creditors would not have recovered anything at all had the first-ranking secured creditor realized on the assets in the ordinary course, then the "punishment" for non-compliance should not be referable to the quantum of the outstanding unsecured debt. Instead, such recourse might be quantified as some sort of function of the transaction costs saved by the vendor and purchaser in avoiding compliance (including timing related savings), together with, possibly, a reasonably proportionate punitive element. In any event, total recovery by the unsecured creditor up to the value of the assets sold does not, under these circumstances, bear any correlation to the gravity of the breach. Of course, normative suggestions as to how the Act should have been drafted are not always persuasive endorsements for a "purposive" construction that runs totally counter to the literal reading of the Act, but it is a consideration that could perhaps have been more thoroughly explored in the dissent.

The *ratio* in *National Trust* will be generally well received by the commercial bar, although, paradoxically, the decision may ultimately prove detrimental to the very goal that it espouses to support. It is almost universally conceded that the Act is, at best, an inconvenient formality, and at worst, a seriously unnecessary transaction cost to be incurred by the parties (whether such costs are incurred in strict compliance or in the structuring necessary to allocate risks for non-compliance). To date, there has been a persistent but relatively flaccid call for legislative reform (mostly for outright repeal of the Act). Although at one time bulk sales legislation was ubiquitous throughout the common law world, many jurisdictions have succumbed to the call for repeal of their bulk sales legislation, including Alberta, British Columbia, Manitoba, Saskatchewan, and the Territories, as well as many of the states in the United States. This annotator sensed widespread distaste for the Court of Appeal reasoning in *National Trust*, perhaps sufficient to reinvigorate a serious political movement for repeal of the Act. However, by relaxing strict compliance in order to achieve some measure of economic efficiency and to avert unjust enrichment of unsecured creditors, the Supreme Court may actually have done more harm than good for the prospect of an outright repeal of the Act in Ontario. This is not, of course, a condemnation of the Supreme Court reasons. The corollary proposition, *i.e.*, that the Supreme Court should have upheld the Court of Appeal decision simply to aggravate commercial interests into demanding repeal of the Act, would have been absurd. Instead, this is but an editorial observation on the political will of modern governments to implement commercial law reform except in reaction to the most extraordinary of circumstances.

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**Statutes considered by *Bastarache J.*:**

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s. 1 "sale in bulk" — considered

s. 3 — referred to

s. 3(1) — considered

s. 4 — referred to

s. 8 — referred to

s. 8(1) — referred to

s. 8(1)(a) — referred to

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s. 8(1)(c) — referred to

s. 8(2)(a) — referred to

s. 9(1) — referred to

s. 12 — referred to

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s. 16(1) — referred to

s. 16(2) — considered

s. 17(1) — referred to

**Statutes considered by *Deschamps J.*:**

*Bulk Sales Act*, R.S.O. 1990, c. B.14
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s. 7 — referred to

s. 8(1) — referred to

s. 8(2) — referred to

s. 16(1) — referred to

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APPEAL by buyer in bulk sale from judgment reported at 2001 CarswellOnt 3682, 151 O.A.C. 82, 56 O.R. (3d) 188, 28 C.B.R. (4th) 251, 18 B.L.R. (3d) 172, 207 D.L.R. (4th) 147, 46 R.P.R. (3d) 182 (Ont. C.A.), dismissing appeal from finding of accountability under bulk sales legislation.

POURVOI de l'acheteur dans le cadre d'une vente en bloc à l'encontre de l'arrêt publié à 2001 CarswellOnt 3682, 151 O.A.C. 82, 56 O.R. (3d) 188, 28 C.B.R. (4th) 251, 18 B.L.R. (3d) 172, 207 D.L.R. (4th) 147, 46 R.P.R. (3d) 182 (Ont. C.A.), qui a rejeté le pourvoi à l'encontre du jugement l'ayant tenu responsable en vertu de la loi régissant les ventes en bloc.

***Bastarache J.*:**

**I. Introduction**

1 This appeal focuses on the application of the remedy provision, under s. 16(2) of Ontario's *Bulk Sales Act*, R.S.O. 1990, c. B.14, when a bulk sale has been declared void for failure to comply with the requirements of the Act. This is the first time this Court has been asked to interpret and apply s. 16(2).

2 The specific issue before this Court is whether, where a sale of stock in bulk has been declared void and set aside for non-compliance with the Act, the value of the stock in bulk for which the buyer is obliged to account to the seller's unpaid creditors under s. 16(2) must be reduced by amounts paid by the seller out of the proceeds of the sale to secured creditors.

3 Tax Time Services Ltd. ("Tax Time") was in the business of tax preparation and the discounting of tax refunds. From 1984 to 1987, the respondent, National Trust Co. ("National Trust"), financed Tax Time's business of discounting income tax refunds. A contract dispute occurred in 1987, and litigation ensued. While this litigation was ongoing, the transaction that is the subject of this appeal took place.

4 In 1991, the appellant, H & R Block Canada Inc. ("H&R Block"), purchased property used by Tax Time for its business of tax preparation and discounting of tax refunds which had a book value of $82,000, for a sale price of $800,000. H&R Block also received a customer list and "goodwill", the benefit of a non-competition clause as well as indemnification from one of the principals of Tax Time for any liability arising from non-compliance with the *Bulk Sales Act*. The transaction between Tax Time and H&R Block was a "bulk sale". H&R Block did not comply with the *Bulk Sales Act*. Specifically, it did not demand or receive a list of creditors from Tax Time; it gave no notice to the creditors of Tax Time; nor did it seek consent from such creditors.

5 At the time of the transaction, in mid-1991, Tax Time's financial situation was not encouraging. All of Tax Time's assets stood as security for loans from the Royal Bank of Canada, First City Trust Co., the National Bank of Canada, Norex Leasing, the Federal Business Development Bank and the Bank of Nova Scotia. Tax Time also had 35 unsecured creditors, one of which was National Trust. Tax Time applied the entire $800,000 against its debts owed to its two most senior-ranking secured creditors, as would have been required under s. 12(1) of the Act (and the *Bankruptcy Act*, R.S.C. 1985, c. B-3). First City Trust Co. was paid $425,000, apparently discharging the debt. However, the Royal Bank was not paid in full. National Trust commenced this proceeding under s. 17(1) of the Act, seeking an accounting from H&R Block for the value of the bulk goods. Significantly, there is no suggestion that Tax Time or H&R Block acted dishonestly, and the sale price of $800,000 is not contested.

6 The *Bulk Sales Act* has at least two significant objectives or purposes: (i) to protect the interests of all creditors whose debtors have disposed of all or substantially all of their assets; and (ii) to ensure the fair distribution of the proceeds of a sale in bulk among the seller's creditors, based on their priority ranking. The clear legislative intent is to deter fraud and to ensure that creditors are properly paid. This said, I am of the view that the *Bulk Sales Act* is not intended to be punitive in nature and that this should be taken into account in its interpretation. A purposive approach to the accounting required under s. 16(2) directs us to look to the substance and not merely the form of the payment to the seller's creditors from the proceeds of the sale. The court retains the discretion to consider all of the facts of the case to determine whether liability to account under s. 16(2) has been fulfilled.

**II. Overview of the Bulk Sales Act**

7 Legislation regulating the sale of bulk goods was first introduced in the United States around the turn of the 20th century. These laws were the product of an initiative by creditors to combat commercial fraud, which was prevalent at that time. See T.C. Billig, "Bulk Sales Laws: A Study in Economic Adjustment" (1928), 77 *U. Pa. L. Rev.* 72, at p. 81. Bulk sales laws were in place in 45 U.S. jurisdictions and in all Canadian jurisdictions by 1922. See: R.M. Forbes, *Handbook: Ontario Bulk Sales Act* (1990).

8 From the outset, bulk sales legislation has been judicially recognized as protecting the interests of creditors whose merchant debtors had disposed of all or substantially all of the inventory, chattels and fixtures by which they carry on business. See *McLennan v. Fulton* (1921), 50 O.L.R. 572 (Ont. C.A.), at p. 577; *St. Thomas Cabinets Ltd., Re* (1921), 61 D.L.R. 487 (Ont. S.C.), at p. 491; and *Crouse, Re*, [1929] S.C.R. 282 (S.C.C.), at pp. 285-86. However, such laws were recently repealed in

 

Alberta, British Columbia, Manitoba, Saskatchewan, Yukon and the Northwest Territories, following reports of law reform commissions in those jurisdictions that the goal of protecting creditors, to the extent that it is achieved by bulk sales legislation, is realized only at the cost of significant commercial inconvenience, disruption and expense. More importantly, these laws were largely seen as unnecessary in light of the availability of remedies under the general law of fraudulent conveyance. See: Law Reform Commission of British Columbia, *Report on Bulk Sales Legislation* (1983), at p. 1; Manitoba Law Reform Commission, *Report on the Bulk Sales Act* (1988), Report No. 71; Northwest Territories Committee on Law Reform, *The Bulk Sales Act* (1990), Working Paper No. 3; Law Reform Commission of Saskatchewan, *The Bulk Sales Act: Report to the Minister of Justice* (1990); R. Bowes, Alberta Law Reform Institute, *The Bulk Sales Act* (1990), Report No. 56.

9 In Ontario, the *Bulk Sales Act* was originally enacted in 1917 (S.O. 1917, c. 33). After minor amendments in 1933, a new Act came into force in 1959 (S.O. 1959, c. 9). The major change in the 1959 legislation was in relation to the consequences of non-compliance with the Act by the buyer of the stock in bulk, which is the issue in this appeal. What are now s. 16(1) and s. 16(2) were introduced as s. 17 to provide unpaid creditors of the seller with a remedy against the buyer. Under the former legislation, the only penalty imposed on a buyer for non-compliance was to render the transaction voidable if it was attacked by the seller's creditors within the statutory limitation period.

10 Section 17 (now s. 16(2)) introduced an alternative remedy for creditors -- an accounting by the buyer of the value of the bulk goods, as well as a personal judgment against the buyer for the value thereof. Specifically, s. 16(2) states that "[i]f a sale in bulk has been set aside or declared void and the buyer has received or taken possession of the stock in bulk, *the buyer is personally liable to account to the creditors of the seller for the value thereof*, including all money, security and property realized or taken by the buyer from, out of, or on account of, the sale or other disposition by the buyer of the stock in bulk" (emphasis added). There have been no substantive changes to the Act since 1959.

11 Ontario's *Bulk Sales Act* applies to any sale of goods "out of the usual course of business or trade of the seller" (s. 1 "sale in bulk"). This means that any sale of substantially all of the assets of a business, or a sale of the assets used to operate the business, as occurred in this case, must comply with the provisions of the Act. Under s. 4, a buyer, before paying or delivering to the seller any part of the proceeds of the sale, must demand and receive from the seller a list of creditors. Under s. 8(1), the sale may proceed only if: the claims of the seller's unsecured creditors do not exceed $2,500 and the claims of the seller's secured creditors do not exceed $2,500 (s. 8(1)(a)); the seller delivers a statement showing that all claims of all creditors, unsecured and secured, have been paid in full (s. 8(1)(b)); or adequate provision has been made for the immediate payment in full of all claims of the creditors, unsecured and secured (s. 8(1)(c)). Under s. 8(2)(a), the sale may proceed only if 60 per cent of the unsecured creditors (by number and amount) have consented to the sale. In this latter case, the sale is to be made through a trustee, appointed under s. 9(1), who must distribute the proceeds in accordance with the priorities set out in the *Bankruptcy Act* (s. 12(1)).

12 The only method available for avoiding this sale by trustee is to obtain a judicial exemption under s. 3(1): "A seller may apply to a judge for an order exempting a sale in bulk from the application of this Act, and the judge, if satisfied, on the affidavit of the seller and any other evidence, that the sale is advantageous to the seller and will not impair the seller's ability to pay creditors in full, may make the order..."

13 Under s. 16(1), a sale in bulk is voidable unless the buyer has complied with the Act. H&R Block did not comply with the Act. At issue, then, is the nature of the remedy under s. 16(2) that is applicable where no fraud has occurred, but where the sale proceeds were paid out by the seller, and not the buyer, to its creditors in the order of their priority credit rankings.

**III. Judicial History**

***A. Ontario Court of Justice (General Division)***

14 At the hearing before the application judge, the parties agreed that the bulk sale did not comply with the Act. The parties also agreed that the "value of the stock in bulk", within the meaning of s. 16(2) of the Act, was $800,000, being the amount that H&R Block paid to purchase this stock from Tax Time.

 

15 Spence J. declared the sale from Tax Time to H&R Block void for non-compliance with the Act. Specifically, he noted that there had been no request for an exemption under s. 3, and no statement had been delivered under s. 4. Neither party appealed this finding. Spence J. ordered H&R Block to account to National Trust for the value of the stock in bulk and held that H&R Block was not entitled to "credit" for the payments made by Tax Time to its secured creditors from the sale proceeds to offset its liability to account for the value of the assets. Spence J. found that in the cases where a buyer had been granted such "credit", it was for amounts paid by the buyer to creditors of the seller over and above the sale price paid by the buyer.

***B. Ontario Court of Appeal (2001), 56 O.R. (3d) 188 (Ont. C.A.)***

*(1) MacPherson J.A. (McMurtry C.J.O. concurring)*

16 In brief reasons, the majority of the Ontario Court of Appeal endorsed the reasoning and conclusion of the application judge as "impeccable". The purpose of the Act is to protect unsecured as well as secured creditors, either by ensuring that all creditors' claims are paid in full, or by allowing the sale to proceed, giving all creditors, including unsecured creditors, an opportunity to state their position on the proposed sale. The parties agreed that the Act was not complied with and that these objectives were not achieved. The argument that National Trust would have been in the same position if the Act had been complied with is based on assumptions about what would have happened if the sale had been executed in accordance with the law. Other outcomes apart from the one assumed by Borins J.A. might have been possible: National Trust might have been able to improve its position had it been given an opportunity to contest the transaction; or it might have been able to argue for a higher purchase price or different sale conditions. It was too late to speculate. A unilateral decision by Tax Time as to how to distribute the proceeds of the sale was not a proper accounting for the value of the stock in bulk.

*(2) Borins J.A. (dissenting)*

17 Borins J.A.'s lengthy dissent includes an overview of the origins, purpose and operation of the *Bulk Sales Act*. His analysis flows from the purpose of the Act, which, in his view, is to prevent a company in trouble from spiriting away all of its assets and to ensure that the assets that remain are distributed among the seller's creditors fairly and ratably. In this case, although the sale did not comply with the Act, it was conducted in such a way that the objectives of the Act were achieved. The proceeds of the sale were distributed exactly as they would have been had the sale proceeded in compliance with the Act under a trustee appointed by a judge; that is, they were paid to secured creditors in order of priority.

18 Borins J.A., at para. 50 held:

> In keeping with the well-accepted nature of an equitable action for an accounting, the buyer is required to provide an account of all money it paid for the stock in bulk and its disbursement by the seller. If the seller has disbursed the proceeds in a manner that has resulted in any creditor not having been paid its full or *pro rata* share, then the buyer must personally pay creditors their full, or ratable, share of the proceeds, up to the value of the stock in bulk.
>
> Here, the obligation to account was discharged when the buyer showed that the seller had disbursed the money among its creditors ratably. Any amount already paid to the seller's creditors should, in effect, be deducted from the buyer's liability. Since the seller had paid the entire value of the assets to its creditors ratably, the buyer was no longer accountable to the creditors.

19 In Borins J.A.'s opinion, it would be inequitable to make H&R Block pay the debt to National Trust under the circumstances. Had H&R Block complied with the Act, National Trust would not have been paid because Tax Time did not have sufficient assets at that point to pay it after the claims of the more highly-ranked secured creditors were satisfied. Section 16(2) would therefore operate to put National Trust in a better position than it would have been in had the sale not occurred or the requirements of the Act been met; National Trust would be the lucky recipient of a windfall. It would also penalize H&R Block unfairly. Since the sale was not a ruse to dispose of Tax Time's assets improperly or cheat its creditors, but was in fact intended to raise funds and improve Tax Time's ability to pay its debts, there was no reason to punish H&R Block for taking part in the transaction.

20 Borins J.A. also held that the remedy provided for under s. 16(2) should follow the same distributional principles as a distribution of proceeds of sale under s. 12(1) -- that is, creditors should be paid in order of priority. An action brought by a creditor under s. 16(2) is a representative action for the benefit of all of the seller's creditors. Therefore, the particular creditor bringing the action should not be allowed to leapfrog over creditors that rank ahead of it.

21 In essence, Borins J.A. was of the view that the nature of an equitable accounting was such that a creditor was due only what he might have recovered if the buyer had complied with the Act; anything more would be unjust enrichment. Furthermore, the buyer's liability should be reduced by any amount paid, by the buyer or by the seller, to creditors in priority ranking. Borins J.A. held that National Trust was therefore not entitled to damages under an equitable accounting.

**IV. Analysis**

***A. The Purpose of the Act***

22 The primary purpose of the *Bulk Sales Act* is to protect the interests of all creditors, secured and unsecured alike, whose debtors have disposed of all or substantially all of their assets. As a secondary purpose, the Act ensures the fair distribution of the proceeds of a sale in bulk; specifically, that the creditors of a seller receive their ratable share of the proceeds of a sale in bulk, based on their priority ranking, and are therefore not prejudiced by the sale. See: *McLennan v. Fulton*, *supra*, at p. 577; *St. Thomas Cabinets Ltd., Re*, *supra*, at p. 491; *Crouse, Re*, *supra*, at pp. 285-86; Reasons of Borins J.A., at para. 48.

23 In furtherance of these objectives, the Act establishes a regime in which buyers and sellers of bulk sales are held to certain measures when carrying out a bulk sale. These measures are designed to deter fraud and to ensure that the interests of creditors are protected, and to this end, the remedies available under the Act provide an incentive for buyers and sellers to comply with the Act. As stated earlier, I am of the view that the *Bulk Sales Act* is not intended to be punitive in nature.

***B. The Section 16(2) Remedy Provision***

*(1) Generally*

24 When determining the remedy under s. 16(2) of the Act, we must place ourselves at the point in time when the sale transaction, which was subsequently declared void, actually took place and *not* the later point in time when the sale transaction was declared void. It was the sale itself that failed to comply with the Act and failed to protect the interests of the seller's creditors. We are, therefore, concerned with the creditors who were left unprotected at that time, their respective debts at that time, and not those remaining five years after the sale, when the sale was declared void.

25 It is also important to clarify that, when dealing with the s. 16(2) remedy provision, it is the *value* of the proceeds, and not the *amount* of the proceeds, that is in issue. The two figures may sometimes be the same. In this case, the value of the proceeds was determined to be $800,000 and that was precisely the amount that H&R Block paid Tax Time for the assets, the customer list and the "goodwill" of the company. However, the value of the proceeds and the amount thereof may often be quite different.

26 The process to be followed by the application judge in applying the s. 16(2) remedy provision is similar to the process used in determining whether an exemption should be granted under s. 3 of the Act. In other words, the application judge will turn his or her mind to similar considerations when deciding on a course of action under either s. 3 or s. 16(2) of the Act. Specifically, the application judge should consider, *inter alia*, how the creditors, both secured and unsecured, would be affected by the sale; whether the sale would be detrimental or beneficial to the creditors; and whether it would have the same impact on each of the creditors, or whether certain creditors would be differentially affected. Would the sale be advantageous to the seller? Would the sale impair the seller's ability to pay the creditors in full? Generally speaking, after considering such factors, if it is reasonable to believe that an application judge would have granted an exemption (i.e., the value of the sale is not detrimental to the creditors), then it is also likely that the buyer will be able to account to unpaid creditors under s. 16(2), providing the proceeds of the sale are paid to the creditors ratably. I, however, do not rely on this proposition as it was not pursued in oral argument before the Court.

 

*(2) Duty to Account*

27 When interpreting a particular provision of an Act, it is important to bear in mind the general purpose of the Act as well as its objectives. Other provisions in the Act will sometimes influence the meaning given to a particular provision. It was suggested here that s. 16(2), and in particular the duty to account, should be interpreted in light of s. 12 of the *Bulk Sales Act*, which states, in part, that the trustee is a trustee for the general benefit of the creditors of the seller and shall distribute the proceeds of the sale among such creditors in like priorities as is required under the *Bankruptcy Act* (Canada). It is my opinion that this is not the case; ss. 12 and 16(2) are distinct. The s. 16(2) remedy provision is a discrete provision and is not dependent on any other particular provision in the Act for interpretation. Instead, the meaning of the phrase "liable to account to" is to be considered in light of the purpose of the Act and of the provision itself in the legislative context.

28 Is an accounting within the meaning of s. 16(2) an equitable remedy under which the buyer should be credited with any payments properly made to priority-ranking creditors through direct payments by the buyer or seller? Or is it an instrument of strict liability, under which the buyer is strictly liable to pay twice if he or she failed to comply with the requirements of the Act? In other words, does the Act direct us to look to the substance, or merely the form, of the payment? H&R Block argued for and Borins J.A., in his dissenting reasons, adopted the former reading. I also adopt this reading.

29 We must interpret the buyer's duty to account under s. 16(2) in light of the rules of statutory interpretation and, in particular, of commercial realities. Accordingly, two factors have heightened importance: (i) predictability, since bright-line rules facilitate transactions and economic efficiency; and (ii) a sensible economic result, also to further economic efficiency. The actual text and case law drive the first of the factors; a purposive approach and policy considerations drive the second.

*(a) Purposive Approach*

30 In light of the objectives of the *Bulk Sales Act*, a purposive approach to the interpretation of the buyer's duty to account under s. 16(2), after having failed to comply with the Act, requires that the buyer pay to the seller's creditors the amount that such creditors were deprived of as a result of the non-compliant sale. In other words, when a buyer fails to conform with the Act, he or she will be liable to the creditors for any shortfall they incurred.

31 Under the purposive approach, creditors are put back in the position they would have been in had the buyer complied with the Act -- no unjust enrichment of creditors takes place. Furthermore, buyers of bulk goods have some incentive to ensure that the appropriate creditors are paid, since the buyer will be liable for any difference. This limited duty of double payment is sufficient, in my opinion, to serve as an incentive to buyers of sales in bulk to protect the interests of the seller's creditors, in accordance with the Act.

*(b) Text*

32 The remedial provision under s. 16(2) of the *Bulk Sales Act* reads:

> If a sale in bulk has been set aside or declared void and the buyer has received or taken possession of the stock in bulk, the buyer is personally liable to account to the creditors of the seller for the value thereof...

33 The phrase, "personally liable ... for the value thereof" suggests that the buyer is liable for the full value of the stock in bulk that was purchased. Such a reading can explain the majority of the Court of Appeal's strict liability interpretation. However, the language of this provision, especially the phrase "personally liable to account", is more consistent with the interpretation that the buyer must account for what is owed, taking into consideration what was properly paid out to creditors from the sale in bulk. This is the preferred interpretation.

34 Historically, an "account" was "a form of action at common law against a person who by reason of some fiduciary relation (as guardian, bailiff, receiver, etc.) was bound to render an account to another, but refused to do so"; *Black's Law Dictionary* (6th ed. 1990), at p.19. It is, therefore, technically an instrument of law, though it arose at a time before the distinction between law and equity was marked. Its beginnings lay in the obligation of manorial bailiffs to tally up rents and expenses, and submit

the difference, to their feudal landlords. Fundamental to the 'account' was that: (i) there were credits and debits to be applied, and a net result arrived at; (ii) it was enforceable at both law and equity, though it was technically a legal obligation; and (iii) it specifically envisaged the use of fungible money -- so there was no need to return the specific property entrusted. See: C.C. Langdell, "A Brief Survey of Equity Jurisdiction" (1888-89), 2 *Harv. L. Rev.* 241, at pp. 246, 252 and 258; see generally: E.O. Belsheim, "The Old Action of Account" (1931-1932), 45 *Harv. L. Rev.* 466.

35 In my opinion, a modern accounting should take into account proper payments to priority-ranking creditors made as a direct result of payment to the seller of the bulk goods and should not result in an unjust enrichment to creditors who would not otherwise have recovered money from a compliant sale. Accounting for the use of proceeds does not equate to repayment of these proceeds by the buyer in every case.

*(c) Relevant Case Law*

36 The jurisprudence in this area is not vast. There are two cases, however, that warrant discussion. In *Sidaplex-Plastic Suppliers Inc. v. Elta Group Inc.* (1998), 40 O.R. (3d) 563 (Ont. C.A.), the Ontario Court of Appeal voided a bulk sale. Rosenberg J.A., writing for the Court of Appeal, noted that s. 8 creates two ways in which the buyer may complete a bulk sale. He further noted that the buyer in that case did not resort to either method. In turning to s. 16(2) and, specifically, the question of whether it grants to a court the discretion to refuse to set aside a sale where there has been non-compliance with the Act, Rosenberg J.A. stated, at p. 573, that "[t]here does not appear to be any [such] authority" and that the "legislation does not expressly give the court such a discretion". He went on to say, at the same page, that the *Bulk Sales Act*

> places the responsibility on the purchaser to engage the mechanisms of the Act to ensure payment of the vendor's creditors. Should the purchaser fail to do so ... the penalty that the purchaser must pay if the sale proceeds are not used to pay the creditors, is to pay the creditors what the vendor should have paid them... Accordingly, except where there has only been some technical non-compliance, <u>the court does not have a discretion to refuse to declare a sale void</u>. [Emphasis added.]

37 Rosenberg J.A. leaves no discretion on the part of the application judge to take into account, for example, proper payments to priority-ranking creditors made as a direct result of payment to the seller of the bulk goods, or to determine whether the circumstances of a particular case are such that double payment by the buyer would lead to an unfair result. Instead, the court suggests that once the buyer has failed to comply with the provisions of the Act, the necessary result is that such buyer be penalized by paying to the creditors what the vendor was required to pay to them. With respect, to the extent that this decision stands for such proposition, it must be rejected. As explained above, such reasoning does not facilitate economically-efficient transactions, nor does it reflect a purposive interpretation of the s. 16(2) remedy provision. Had Spence J. not been required to follow *Sidaplex, supra*, he should, on the interpretation given here, have simply refused to set aside the bulk sale.

38 In *Motorsource Inc. v. A.O. Smith Corp.* (1993), 8 Alta. L.R. (3d) 1 (Alta. C.A.), Motorsource, in a fraudulent scheme, sold all of its inventory of electric motors at fair market value (or better) to Southern Rewind. The proceeds of the sale were then distributed, first to pay off its secured creditor, Royal Bank. The rest of the proceeds flowed back to Southern Rewind (which was owned by the same person) against its alleged debt. Acknowledging the direct ruling from the trial judge on the fraudulent intention on the part of Motorsource to give security to Southern Rewind in furtherance of an intention to hinder other creditors, the Court of Appeal turned its attention to whether or not it should void the sale. After again noting that the sale was for fair market value, or higher, Kerans J.A., writing for the court, held that there was no need to void the sale. The court did not rigidly apply the statutory remedy available in the *Bulk Sales Act* but instead used its discretion to deal with the non-compliant sale "on just terms". In realizing that the only result of voiding the sale would be to require that the motors be taken from Southern Rewind and sold on the market, the court stated, at para. 6, that "[t]hat does not seem to be in the best interests of anybody. So we will not do that. We will let that sale go as being the best possible sale". The conveyance of money to Southern Rewind was, however, voided in order to distribute *pro rata* to creditors.

39 The significance of this case lies in the Alberta Court of Appeal's use of discretion not to void the sale, and to adopt the actions that would put creditors in the place they would have been in had the Act been complied with. Southern Rewind was effectively given "credit" for the payment to Royal Bank.

40 In the facts of the case before us, one of the conditions of the sale from Tax Time to H&R Block was that the proceeds of the sale be used to pay Tax Time's creditors in order of priority in order to secure a free title. Holding H&R Block strictly liable to pay National Trust the value of the proceeds of the bulk sale, under these circumstances, would lead to a very unfair result and in the words of Kerans J.A., "does not seem to be in the best interests of anybody", *Motorsource, supra*, at para. 6. The inclusion of this condition of sale is consistent with the general purpose of the Act, which is to protect the interests of all creditors whose debtors have disposed of all or substantially all of their assets, and to ensure the fair distribution of the proceeds of a sale in bulk. While the inclusion of this condition of sale is quite compelling in the present case, it should not be seen as a requirement in the decision-making process of determining whether or not to relieve the non-compliant buyer of a strict liability to account to the seller's creditors. Instead, it constitutes a factor to consider in the general context of the sale.

41 The respondent argued that if one factored in the goodwill of the company at the time of the bulk sale, all creditors could have been paid. This suggests that a bankruptcy would have permitted National Trust to realize the $800,000 sale, and to obtain $600,000 more for other assets, that the non-competition clause was irrelevant and that all transactions could have been completed rapidly. I agree with the appellant that this is speculation and that resort to such a scenario has nothing to do with the proper interpretation of s. 16(2). This section does not contemplate comparison with a potential bankruptcy. In this case, the $800,000 was advantageous because it reflected the best possible price and eased the situation of the company in carrying on business in the future. The issue is whether National Trust was deprived of any money it would have received on a ratable distribution of the proceeds of the bulk sale. That, I think, is in the true nature of an equitable accounting.

*(d) Policy Considerations*

42 In the context of transactional business law, there are strong policy reasons for facilitating efficient transactions while protecting creditors. As I have already noted, bulk sales legislation was recently repealed in the western provinces and in two of the three territories, following reports of their respective law reform commissions that the goal of protecting creditors, to the extent that it is achieved by bulk sales legislation, is realized only at the cost of significant commercial inconvenience, disruption and expense. There has been no decision to repeal the Act in Ontario. The Act must therefore accommodate modern commercial realities as best it can.

43 As a matter of policy, a strong argument for a "strict liability" reading of the duty to account is one focused on certainty. A strict accounting is a bright-line rule: if you do not comply, then you pay twice. Indeed, and as noted below, the wording of s. 16(2) could be seen to support such a view. It is my opinion, however, that a purposive approach to s. 16(2) precludes such an interpretation. With great respect for my colleague's dissenting reasons, it seems unreasonable that an unsecured creditor who would not have recovered any payment *even if* the buyer had complied with the Act, should now be in a position to benefit from the buyer's non-compliance with the Act.

44 The Act reflects a desire to deter fraud and to ensure that creditors are properly paid. Accordingly, a non-compliant buyer may be ordered to account in cases where there has been no proper payment to the seller's creditors. However, there is no legislative intent to punish non-compliant buyers in cases where there has been proper payment to the seller's creditors, whether that payment was made by the buyer or the seller. In such cases, the court should review all of the facts of the case and use its discretion in determining what, if anything, should be done to put the unpaid creditors in the position they would have been in had the Act been complied with or whether a strict liability to account, under s. 16(2), would lead to an unfair result.

***C. Application to this Appeal***

45 Tax Time became a money-losing enterprise. To maximize value to its creditors, some of whom were sure to go unpaid, Tax Time decided it was best to wind up the business and sell the customer list. Tax Time received fair market value for its customer list.

46 H&R Block, as buyer, did not comply with the provisions of the Act and, as such, the sale in bulk from Tax Time was declared void under s. 16(1). Under s. 16(2), H&R Block became personally liable to account to the creditors of the seller for the value of the stock in bulk. In light of the purpose of the Act, and in accordance with a purposive reading of s. 16(2), H&R

Block's duty to account requires that the buyer pay to the seller's creditors the amount that such creditors were deprived of as a result of the non-compliant sale. Payments to creditors made directly from the proceeds of the bulk sale may be credited to the buyer, regardless of whether H&R Block or Tax Time made the payment. Tax Time's payments to its two highest-ranking creditors did not place National Trust at a disadvantage. To require H&R Block to now pay to National Trust the value of the proceeds of the sale would be to place National Trust in a better position than it would have been in had the requirements of the Act been met; National Trust would be the lucky recipient of a windfall and H&R Block would be unduly punished. This would be a very unfair result; National Trust is, therefore, not entitled to damages under the s. 16(2) duty to account.

**V. Conclusion**

47 We must interpret the buyer's duty to account under s. 16(2) in light of the rules of statutory interpretation and, in particular, of the true purpose of the Act and of commercial realities. In this context, the phrase "personally liable to account" is consistent with the interpretation that the buyer must account for what is owed, taking into account what was properly paid out to creditors from the proceeds of the sale in bulk. A purposive approach directs us to look to the substance, and not merely the form, of the payments made. The court retains the discretion to consider all of the facts of the case to determine what, if anything, should be done to put the unpaid creditors in the position they would have been in had the Act been complied with or whether a strict liability to pay, under s. 16(2), would lead to an unfair result. The creditor should not be placed in a better position than it would have been in had the buyer complied with the Act; conversely, the non-compliant buyer should not be unduly punished. A modern accounting should take into account proper payments to priority-ranking creditors made as a direct result of payment to the seller of the bulk goods.

48 The appeal is allowed with costs throughout.

***Deschamps J.*:**

49 Where the law is clear, not even the most dynamic interpretation can justify going beyond the rules set out regarding the consequences of its violation. The issue here is therefore not what would have happened if the law had been obeyed, but rather how to apply the requirements of s. 16(2) of the *Bulk Sales Act*, R.S.O. 1990, c. B.14 ("Act"), so that it is consistent with the objectives and spirit of the Act.

**I. Objectives of the Bulk Sales Act**

50 After the federal *Insolvent Act of 1875*, S.C. 1875, c. 16, was repealed in 1880, the provinces of Canada were concerned that creditors be protected. A number of provinces, undoubtedly inspired by the experience in the United States (T.C. Billig, "Bulk Sales Law: A Study in Economic Adjustment" (1928), 77 *U. Pa. L. Rev.* 72, at p. 81), enacted bulk sales legislation; Ontario, in 1917, was one of them.

51 The general objective was to improve the position of creditors when debtors sold their businesses, a situation that was easy for debtors to abuse. See: *Higgins v. Elliott* (1922), 65 D.L.R. 154 (N.S. C.A.), at p. 164. In *McLennan v. Fulton* (1921), 50 O.L.R. 572 (Ont. C.A.), at p. 577, Hodgins J.A. of the Ontario Court of Appeal wrote: "The aim of the Act is to prevent a person, partnership, or company disposing of his or its assets in bulk, and pocketing the money, leaving creditors in the lurch". This objective has been frequently reiterated by the courts. See: *St. Thomas Cabinets Ltd., Re* (1921), 61 D.L.R. 487 (Ont. S.C.), at p. 491, *Crouse, Re*, [1929] S.C.R. 282 (S.C.C.), at pp. 285-86.

52 Three mutually complementary mechanisms, reinforced by a sanction, oparate to achieve this general objective. These mechanisms and sanction are also aimed at specific objectives and at responding to particular needs.

53 The first mechanism is a judicial exemption (s. 3) granted on evidence that the sale is advantageous to the seller and will not impair the seller's ability to pay creditors in full. The general objective of the Act is completely met by that mechanism, which is available only when the financial health of the business is not affected by the proposed sale. The specific objective of that mechanism is to provide the parties with an alternative in the event that the Act is regarded as imposing an unnecessary requirement. Because the Act applies to all sales made out of the usual course of business, some transactions may have no effect

on the business. However, the creditors may demand that the seller or buyer provide them with particulars in writing of the sale in bulk (s. 7). All necessary transparency is guaranteed.

54 Under the second mechanism, the buyer must demand of the seller a statement providing the details of debts owing to secured and unsecured trade creditors (s. 4). The buyer may pay the seller (s. 8(1)) only if the latter states that he or she has paid or made provision for his or her debts, or the debts do not exceed $2,500, or the excluded creditors have waived the provisions of the Act. The general objective of the Act is met, because the creditors are not at risk of having the proceeds of the sale paid to the seller before the debt owing to them is paid. The specific objective of this second mechanism is to make the buyer responsible for obtaining the statement in question, and to compel the buyer to withhold payment of the selling price until the buyer has arranged for payment of the debts owing to trade creditors.

55 The third mechanism involves a sort of liquidation under judicial supervision (s. 8(2)). It is conducted by a trustee with the agreement of a special majority of unsecured creditors, or is ordered by a judge where the creditors consent to the sale but not to the appointment of the trustee. This route must be taken where the sale price is not sufficient to pay all the creditors, or where the seller is not able to provide a statement deposing that the seller has made provision for payment of the debts. The general objective of reassuring creditors is met by this mechanism, since the proceeds of the sale are used to pay the business's debts and all creditors are treated equitably. The specific objective is to ensure that creditors are consulted and to transfer responsibility to a trustee for distributing the proceeds of the sale.

56 The three mechanisms are supplemented by a sanction, which allows the creditors to receive an amount equal to the value of the property sold. That mechanism is also intended to compel the parties to the deed of sale to comply with the Act. The statutory sanction is that the sale may be set aside (s. 16(1)). If that occurs, the buyer must account to the creditors for the value of the property that the buyer acquired in the sale (s. 16(2)). The specific objective is to restore the creditors to the position they were in before the sale. Therefore, a sale is set aside, the buyer no longer owns the property and must return it to the seller, and must refund the sale price. Since it is often impossible for the property to be returned in full, because the buyer has used or disposed of the property, the Act requires that the buyer account for the value of the property. The Act simplifies the usual mechanism associated with setting aside a sale by conferring the benefit on the group that the Act is intended to protect. The sanction also acts as a strong deterrent, since the buyer becomes personally subject to the duty to account. The buyer is made the guarantor of compliance with the requirements of the Act. See: Law Reform Commission of British Columbia, *Report on Bulk Sales Legislation* (1983), at pp. 25-26. Under the rules that apply when a sale is set aside, the buyer may claim a refund from the seller of the amount paid. Nevertheless, under the Act, the buyer is personally liable to the business's creditors at the time the sale takes place.

57 The sanction provided in s. 16(2) is essential to the proper operation of the Act. Neither the buyer nor the seller would have an incentive for complying with the Act if there were no sanction for non-compliance. Without the sanction, the Act would be nothing but wishful thinking, and would thus fail to achieve either its general or specific objectives. If the Act had no teeth, it would serve no useful purpose.

58 The judicial review that is provided for in relation to the sanction neither can nor should be used to render the three protection mechanisms moot. Where an application is brought to a judge under s. 16(1), the judge may not refuse to set aside the sale unless it is justified in the circumstances and the exercise of discretion would meet the objectives of the Act. An example of the exercise of discretion is offered in *Motorsource Inc. v. A.O. Smith Corp.* (1993), 8 Alta. L.R. (3d) 1 (Alta. C.A.). In that decision, the sale price paid was equal to or greater than the market value of the property. The Alberta Court of Appeal therefore refused to set the sale aside, on the ground that doing so would be in no one's interest. On the other hand, in *Sidaplex-Plastic Suppliers Inc. v. Elta Group Inc.* (1998), 40 O.R. (3d) 563 (Ont. C.A.), Rosenberg J.A. was of the opinion that the judge had no discretion. However, he nonetheless acknowledged that mere technical non-compliance may justify refusing to declare a sale void.

59 In my opinion, the Act leaves room for discretion to be exercised, but that discretion is limited. Mere speculation that the proceeds of sale would have been distributed to a secured creditor and that the complainant creditor would not have been paid in a judicial liquidation is not sufficient. The judge must weigh several factors. If the judge decides to decline to void the sale,

he or she must be satisfied that the transaction is advantageous to all creditors protected by the Act, that the parties to the sale had a legitimate reason or an excuse for not complying with the Act, and that the objective of deterrence was not circumvented.

60 An *ex post facto* analysis of what complying with the Act would have meant for creditors is neither desirable nor useful. The context in which the sale of all or part of the assets of a business is negotiated is extremely complex, and any reconstruction can only amount to speculation. Apart from the discretion inherent in the decision as to whether or not to void the sale, the Act does not provide for such a reconstructive exercise to be conducted. If the parties comply with the Act, the situation of the creditors will be much clearer and more certain than if a judge were to assess how advantageous a transaction would have been to them based on hypotheticals that may vary, in number and nature, from one creditor to another.

61 If the parties do not comply with the Act and the sale is set aside, there is no room for any speculation. The buyer must account to the creditors for the value of the property purchased.

**II. The Spirit and Letter of the Bulk Sales Act**

62 As Bastarache J. observes, the Act states a bright-line rule. If the sale is set aside, the buyer is then personally liable to account. Can that bright-line rule be interpreted in such a way as to take the payments made by the seller into account? In my opinion, the answer is no.

63 Section 16(2) reads as follows:

> If a sale in bulk has been set aside or declared void and the buyer has received or taken possession of the stock in bulk, the buyer is personally liable to account to the creditors of the seller for the value thereof, including all money, security and property realized or taken by the buyer from, out of, or on account of, the sale or other disposition by the buyer of the stock in bulk.

64 Under this provision, the buyer is liable to account for the value of the stock in bulk, and not for the value of the proceeds of sale. This is an important nuance, not only because the amount may be different but also because the sanction applies to the buyer's personal assets and not to whatever has become of the proceeds of the sale.

65 The purpose of the Act is to hold the buyer liable for an amount equal to the value of the property. An interpretation based on the use of the proceeds of sale to pay the secured creditors would undermine the spirit of the Act, which is intended to protect not only secured creditors but also ordinary creditors. Such an interpretation would also do violence to the wording chosen by Parliament, in that it substitutes the words "proceeds of the sale" for "value thereof". Under s. 16(2), the use made by the seller of the sale price received by the seller is of no relevance. Section 16(2) deals only with the buyer's liability to the creditors.

66 As well, because the Act's objective is to protect all the creditors, it would seem logical to prefer an interpretation under which that objective is more fully met by compliance rather than non-compliance. Non-compliance obviates the protection mechanisms, while compliance makes it more likely that the objectives of the Act will be achieved. The consequence of violating the Act must therefore be different from the consequence of complying with the Act.

67 Moreover, assessing the extent of the buyer's liability does not require any exercise of discretion by the judge. Accordingly, at this stage, and after the judge has set aside the sale, it is inappropriate to inquire into the motivations that might have prompted a seller or buyer not to comply with the requirements of the Act.

68 Above all, if the provincial legislature has not yet decided to repeal the Act, it is not the function of the courts to substitute their own judgment for it. An interpretation that eliminates the consequences of violating the Act would be an implicit repeal of the Act, and amount to a negation of the democratic institutional process.

**III. Application to the Facts of the Case**

69 The trial judge found that the sale was void. That finding was not appealed, and there is no reason to believe that it was either made or not appealed from out of inadvertence. The parties did not offer any formal explanation for their non-compliance

 

with the Act, although there can be no doubt, from certain clauses, that they did so with full knowledge of what they were doing: Tax Times and its president expressly undertook to indemnify H & R Block for any liability arising out of non-compliance with the Act. That clause cannot be interpreted otherwise than as a statement of non-compliance, because the buyer was not provided with either a statement or an exemption, and the creditors were not consulted. The only possible conclusion is that the parties had business reasons for taking the route they chose.

70 As well, there is nothing in the evidence that would suggest that the transaction was obviously advantageous to the creditors and that this justified disregarding the objectives of protection, transparency, consultation and deterrence. On the contrary, as noted earlier, and as MacPherson J.A. of the Court of Appeal wrote ((2001), 56 O.R. (3d) 188 (Ont. C.A.)), the argument that National Trust would have been in the same position if there had been compliance with the Act is based on pure speculation. Even though it was not proven that National Trust would have been able to have the terms of the sale changed if it had been consulted, the reverse is by no means obvious either. To encourage incorporating discretion at the stage of the duty to account can only provide sellers and buyers with an incentive to evade the application of the Act.

71 The exercise engaged in by Borins J.A. of the Court of Appeal, and which my colleague Bastarache J. has adopted, is not, with respect, consistent with either the general objective of the Act or its specific objectives. Participation by all classes of creditors, and more specifically by the ordinary creditor class, is circumvented, judicial review is evaded, and the parties have no incentive to comply with the Act because all that needs to be done in order for the buyer and seller to escape any sanction is to prove that the secured creditors have received an amount equal to the value of the proceeds. Creditors will not be reassured by an interpretation that allows their debtors to sell their assets on the sly.

72 As well, I do not find persuasive the argument that there is justification for giving the judge *ex post facto* discretion because it would be undesirable for National Trust to be paid when it would not have been paid if Tax Times had been liquidated. The law does not provide for a windfall. The Act simply sets out the consequence of the commercial risk that the buyer and seller take when they fail to comply with one of its provisions. It is by no means obvious that H & R Block would have to pay twice because Tax Time and its president undertook to indemnify them. Therefore it is not necessarily penalized by the application of the Act.

73 When the Act is applied, there are financial consequences, which the parties anticipated. It is not the function of judges to substitute their judgment for the wills of the legislature or the parties simply to minimize the impact of commercial legislation that they believe to be cumbersome or unfair.

**IV. Conclusion**

74 Legislation must be interpreted having regard to the objectives, spirit and letter of the law. I am of the opinion that after a sale is declared void, the duty to account for the property is automatic. Having regard to all these factors, I conclude that the Court of Appeal was correct to decline to intervene.

*Appeal allowed.*

*Pourvoi accueilli.*

Footnotes

* A corrigendum issued by the court on November 18, 2003 has been incorporated herein.

# TAB 7

2009 ONCA 171
Ontario Court of Appeal

GE Canada Equipment Financing G.P. v. ING Insurance Co. of Canada

2009 CarswellOnt 928, 2009 ONCA 171, [2009] I.L.R. I-4812, 14 P.P.S.A.C. (3d) 49, 175 A.C.W.S. (3d) 256, 248 O.A.C. 83, 308 D.L.R. (4th) 127, 51 C.B.R. (5th) 47, 70 C.C.L.I. (4th) 165, 94 O.R. (3d) 321

# GE Canada Equipment Financing G.P. (Applicant / Appellant) and ING Insurance Company of Canada (Respondent / Respondent in Appeal)

E.A. Cronk, J. MacFarland, R.G. Juriansz JJ.A.

Heard: October 2, 2008
Judgment: February 25, 2009
Docket: CA C48486

Proceedings: reversing *GE Canada Equipment Financing G.P. v. ING Insurance Co. of Canada* (2008), 2008 CarswellOnt 522, 57 C.C.L.I. (4th) 230, 12 P.P.S.A.C. (3d) 237, 39 C.B.R. (5th) 315 (Ont. S.C.J.)

Counsel: Harvey G. Chaiton, Doug Bourassa for Appellant
Adam J. Stephens, Nafisah Chowdhury for Respondent

Subject: Insurance; Corporate and Commercial; Insolvency; Civil Practice and Procedure

**Related Abridgment Classifications**
For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

**Headnote**

**Insurance --- Miscellaneous issues**

Financier financed two tractors for rental company — Financier retained title to vehicles until they were fully paid for — Financier registered its interests in tractors under Personal Property Security Act ("PPSA") — Rental company leased vehicles to third parties who in turn obtained insurance from insurer, naming themselves as lessees and rental company as lessor of vehicles, but financier was not named in policies — There was no evidence that third parties knew, and there was evidence that insurer did not know, of financier's interest in vehicles — Vehicles were stolen — Proof of loss forms did not state financier's interest — Insurer paid claim to third parties and rental company — Rental company transferred ownership of vehicles to insurer — Vehicles were found and insurer took possession — Financier's application for declaration that its security interests had priority over insurer's and for declaration that financier was entitled to return of vehicles or proceeds of sale thereof was dismissed — Trial judge found financier's interest in vehicles vis-a-vis insurer was not protected by PPSA because PPSA does not apply to transfer of interest under policy of insurance — Trial judge found there was such transfer of interest by virtue of Statutory Condition — Financier appealed — Appeal allowed — Combined effect of PPSA and condition did not deprive financier of its priority — Financier had registered interest first — Insurer was relieved of obligation to file interest under PPSA under s. 4(1)(c), but priority not otherwise affected — Transfer of ownership was not secured transaction, rather purported ownership was transferred to insurer in exchange for indemnification under policy for loss — Financier's claim was for truck itself not insurance proceeds — Statutory conditions did not vest salvage rights in insurer free and clear of any other obligation — Trial judge did not properly consider issue of subrogation — Statutory condition codified subrogation, which was derivative right that puts insurer in same position as insured — Commercial and common sense served by giving priority to financier, otherwise insurer would have more rights in property than insured.

**Personal property security --- Scope of legislation — Insurance and annuities**

Financier financed two tractors for rental company — Financier retained title to vehicles until they were fully paid for — Financier registered its interests in tractors under Personal Property Security Act ("PPSA") — Rental company leased vehicles to third parties who in turn obtained insurance from insurer, naming themselves as lessees and rental company as lessor of vehicles, but financier was not named in policies — There was no evidence that third parties knew, and there was evidence that insurer did not know, of financier's interest in vehicles — Vehicles were stolen — Proof of loss forms did not state financier's interest — Insurer paid claim to third parties and rental company — Rental company transferred ownership of vehicles to insurer — Vehicles were found and insurer took possession — Financier's application for declaration that its security interests had priority over insurer's and for declaration that financier was entitled to return of vehicles or proceeds of sale thereof was dismissed — Trial judge found financier's interest in vehicles vis-a-vis insurer was not protected by PPSA because PPSA does not apply to transfer of interest under policy of insurance — Trial judge found there was such transfer of interest by virtue of Statutory Condition — Financier appealed — Appeal allowed — Combined effect of PPSA and condition did not deprive financier of its priority — Financier had registered interest first — Central priorities rule in PPSA made financier's interest effective between debtor and third parties — Transfer was not sale taken free of any security interest under s. 28(1) of PPSA — Transfer occurred according to terms of contract rather than actual sale, and was not carried out in ordinary course of business — Rental company did not engage in sale of vehicles — Rental company obtained proceeds through misrepresentation, by claiming that no security interest existed — Financier did not authorize dealing with trucks free and clear of security interest, and description of trucks as inventory did not give insured authority to deal with trucks as it saw fit — Unreasonable that financier should lose priority due to being misled by insured.

**Personal property security --- Priority of security interest — Miscellaneous**

Financier financed two tractors for rental company — Financier retained title to vehicles until they were fully paid for — Financier registered its interests in tractors under Personal Property Security Act ("PPSA") — Rental company leased vehicles to third parties who in turn obtained insurance from insurer, naming themselves as lessees and rental company as lessor of vehicles, but financier was not named in policies — There was no evidence that third parties knew, and there was evidence that insurer did not know, of financier's interest in vehicles — Vehicles were stolen — Proof of loss forms did not state financier's interest — Insurer paid claim to third parties and rental company — Rental company transferred ownership of vehicles to insurer — Vehicles were found and insurer took possession — Financier's application for declaration that its security interests had priority over insurer's and for declaration that financier was entitled to return of vehicles or proceeds of sale thereof was dismissed.

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*DaimlerChrysler Financial Services (Debis) Canada Inc. v. Mega Pets Ltd.* (2002), 212 D.L.R. (4th) 41, 1 B.C.L.R. (4th) 237, 33 C.B.R. (4th) 44, [2002] 5 W.W.R. 587, 22 B.L.R. (3d) 14, [2003] 3 C.T.C. 400, 166 B.C.A.C. 298, 271 W.A.C. 298, 2003 D.T.C. 5612, 2002 BCCA 242, 2002 CarswellBC 786 (B.C. C.A.) — referred to

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*1231640 Ontario Inc., Re* (2008), 2008 CarswellOnt 2897, 2008 CarswellOnt 2898 (S.C.C.) — referred to

**Statutes considered:**

*Insurance Act*, R.S.O. 1990, c. I.8

Generally — referred to

s. 234(1) — considered

s. 258(3) — considered

*Personal Property Security Act*, R.S.O. 1990, c. P.10
Generally — referred to

s. 2(a) — considered

s. 4(1) — referred to

s. 4(1)(a) — considered

s. 4(1)(c) — considered

s. 9(1) — considered

s. 25(1) — considered

s. 25(1)(a) — considered

s. 28 — referred to

s. 28(1) — considered

s. 28(5) — referred to

*Uniform Commercial Code*
Article 9 — referred to

Article 9-104(g) — considered

Article 9-109(d)(8) — considered

**Regulations considered:**

*Insurance Act*, R.S.O. 1990, c. I.8
*Statutory Conditions — Automobile Insurance*, O. Reg. 777/93

s. 6(7) — considered

APPEAL by financier from judgment reported at *GE Canada Equipment Financing G.P. v. ING Insurance Co. of Canada* (2008), 2008 CarswellOnt 522, 57 C.C.L.I. (4th) 230, 12 P.P.S.A.C. (3d) 237, 39 C.B.R. (5th) 315 (Ont. S.C.J.), dismissing application by financier for declaration regarding priority in dispute arising out of auto theft and recovery.

***E.A. Cronk J.A.:***

1 This appeal involves a priority dispute between a secured creditor who holds perfected security interests under the *Personal Property Security Act*, R.S.O. 1990, c. P.10 (the "PPSA") in two highway tractor trucks and an automobile insurer who is entitled to salvage rights in the same vehicles under statutory condition 6(7) in *Statutory Conditions — Automobile Insurance*, O. Reg. 777/93 passed under the *Insurance Act*, R.S.O. 1990, c. I.8, as amended (the "Insurance Act"). At issue is the interplay between s. 4(1)(c) of the PPSA, which excludes "a transfer of an interest or claim in or under any policy of insurance" from

 

the application of the PPSA, and statutory condition 6(7) of the Insurance Act, which affords an insurer the right to salvage in an insured vehicle in certain circumstances. We are also required to determine whether ss. 28(1) or 25(1) of the PPSA operate in this case to determine the priority contest between the parties.

**I. Facts**

***(1) The Parties and the Events***

2 The appellant, GE Canada Equipment Financing G.P. ("GE"), an asset-backed lender, leases or conditionally sells various types of collateral, including highway tractor trucks. The respondent, ING Insurance Company of Canada ("ING"), offers a range of insurance products and services to the public, including automobile insurance. At the relevant time, Brampton Leasing and Rentals Limited ("Brampton") was in the vehicle leasing and rental business, operating as a Hertz car and truck rental agency.

3 GE financed the purchase of numerous vehicles for use by Brampton in its leasing and rental business. In particular, on September 18, 2002 and November 18, 2004, GE entered into two conditional sale agreements (the "CSAs") with Brampton, whereby GE financed Brampton's acquisition of two highway tractor trucks manufactured in 2003 and 2005 (referred to in these reasons as the "2003 Truck", the "2005 Truck" or, collectively, the "Trucks").

4 Under the terms of the CSAs: (i) GE was named as the "assignee" and Brampton was named as the "purchaser" of the Trucks; (ii) GE remained the owner of and held title to the Trucks until they were paid for in full; (iii) Brampton was required to place and maintain comprehensive first party all risks insurance on the Trucks for their full replacement value, to name GE as a beneficiary in the insurance policies so obtained, and to ensure that the policies contained a waiver of subrogation clause in favour of GE; and (iv) while not in default under the CSAs, Brampton was entitled to the quiet use and enjoyment of the Trucks.

5 By the end of November 2004, GE had taken all necessary steps under the PPSA to perfect its purchase money security interests ("PMSIs") in the Trucks and their proceeds. [1]

6 In accordance with its obligations under the CSAs, Brampton obtained comprehensive general liability insurance policies on the Trucks from Zurich Insurance Company, naming GE as loss payee thereunder. In addition, in February and May 2005, when Brampton leased the Trucks to two separate third parties, each lessee obtained automobile insurance on its leased vehicle under a policy of insurance issued by ING (the "ING policies"). The third parties were named as the insureds and lessees, and Brampton was named as the lessor and loss payee under the ING policies. No mention was made of GE in the ING policies.

7 After the ING policies were issued, both Trucks were stolen. As a result, in September 2005 and May 2006, the third party lessees completed loss claims and Brampton submitted proof of loss forms to ING in respect of the stolen Trucks. In the latter documents, Brampton falsely represented in relation to the Trucks: "[N]o person, firm, or corporation, other than the Insured, has had any interest therein, and there is no lien, chattel mortgage, or conditional sales agreement thereon."

8 In consideration for the receipt of the ING insurance proceeds, Brampton also purported to transfer title to the Trucks to ING in circumstances of a vehicle total loss claim (the "Transfer"). The proof of loss forms stated:

> Payment of this claim to [the insured and Brampton] is hereby authorized and in consideration of such payment the Insurer is discharged forever from all further claim by reason of the said loss or damage. All rights to recovery from any other person are hereby transferred to the Insurer which is authorized to bring action in the Insured's name to enforce such rights. *All right, title and interest in the vehicle or any part or equipment thereof is hereby transferred to the Insurer only in the event that this claim is based upon the whole value of the vehicle because it has been lost, destroyed or damaged beyond economical repair and the Insured agrees immediately to notify the Insurer in the event of its recovery.* [Emphasis added.]

The record does not reveal how the Transfer contemplated by this provision was actually made.

9 ING accepted the loss claims and discharged its indemnity obligations under the ING policies by paying the cash value of the stolen Trucks jointly to Brampton and the third party lessees, less applicable deductibles. As a result, as I discuss later in these reasons, ING became entitled to salvage rights in the Trucks under statutory condition 6(7) of the Insurance Act.

10 ING did not conduct PPSA searches prior to issuing the ING policies, paying the ING insurance proceeds, or accepting title to the Trucks from Brampton.

11 Both Trucks were later recovered and ING took possession of them. ING then sold the 2005 Truck to an unrelated party. As a result of this litigation, ING has retained possession of the 2003 Truck and the proceeds from the sale of the 2005 Truck.

12 Brampton did not notify GE of the theft of the Trucks. On the contrary, it continued to make payments to GE under the CSAs for some months after the Trucks were stolen. Similarly, GE received no notice of the terms of the ING policies, the claims made thereunder by Brampton and the third party lessees, the payment to them of the ING insurance proceeds, or the Transfer. None of the ING insurance proceeds was remitted to GE.

13 Brampton defaulted in its payment obligations under the CSAs in December 2006 and filed an assignment in bankruptcy on March 1, 2007. GE learned of the theft of the Trucks when it attempted to exercise its remedies on default under the CSAs. On March 14, 2007, GE obtained used vehicle information packages for the Trucks from the Ministry of Transportation, which indicated that ING was the registered owner of the 2003 Truck and that it had owned, and subsequently sold, the 2005 Truck. The packages also identified GE as a "secured party" and a registered lienholder in relation to both Trucks.

14 There is no suggestion that the third party lessees or ING knew of GE's PMSIs in the Trucks prior to the end of March 2007, when GE wrote to ING and informed it of GE's perfected PMSIs in the Trucks. Brampton, of course, knew of GE's PMSIs throughout.

***(2) Relevant Statutory Provisions***

15 The following statutory provisions are central to the issues on appeal:

**A. The PPSA**

4.(1) Except as otherwise provided under this Act, this Act does not apply,

. . . . .

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

. . . . .

9.(1) Except as otherwise provided by this or any other Act, a security agreement is effective according to its terms between the parties to it and against third parties.

. . . . .

25.(1) Where collateral gives rise to proceeds, the security interest therein,

(a) continues as to the collateral, unless the secured party expressly or impliedly authorized the dealing with the collateral free of the security interest; and

(b) extends to the proceeds.

. . . . .

28.(1) A buyer of goods from a seller who sells the goods in the ordinary course of business takes them free from any security interest therein given by the seller even though it is perfected and the buyer knows of it, unless the buyer also knew that the sale constituted a breach of the security agreement.

**B. Statutory Condition 6(7) of the Insurance Act**

There shall be no abandonment of the automobile to the insurer without the insurer's consent. If the insurer exercises the option to replace the automobile or pays the actual cash value of the automobile, the salvage, if any, shall vest in the insurer.

***(3) The Litigation***

16 Despite demand therefor, ING refused to surrender possession of the 2003 Truck or to pay the proceeds from the sale of the 2005 Truck to GE. As a result, GE commenced proceedings against ING, applying for declarations that: (i) its PMSIs in the Trucks had priority over ING's rights to salvage in the same vehicles; and (ii) it was entitled to the return of the Trucks or, in the case of the 2005 Truck, to the proceeds of sale thereof, from ING.

17 ING resisted GE's application on two grounds. It maintained that its salvage rights flowed from the ING policies, which incorporated statutory condition 6(7) of the Insurance Act, and that the PPSA did not apply to its interests in the Trucks by virtue of s. 4(1)(c) of the PPSA and statutory condition 6(7) of the Insurance Act. ING also argued that as the Transfer was a "[sale] in the ordinary course of business", the PPSA did not apply by operation of s. 28(1) of the PPSA. On both grounds, ING asserted that it took title to the Trucks free from GE's pre-existing perfected PMSIs in the Trucks.

18 By order dated February 4, 2008, [(2008), 2008 CarswellOnt 522 (Ont. S.C.J.)] the application judge dismissed GE's application and, on consent, awarded costs to ING in the total amount of $15,000, plus interest. The core of his reasoning was as follows:

As a matter of priority, the PPSA, in effect, has stated that GE is not to have priority over transfers of interest to ING by reason of the operation of Statutory Condition 6(7) which is incorporated into insurance policies.

**Conclusion**

I find that GE's interest in the vehicles *vis a vis* ING is not protected by the PPSA for the reason that [the] PPSA does not apply to a transfer of an interest under a policy of insurance [s. 4(1)(c) of the PPSA]. There was such a transfer of an interest by virtue of Statutory Condition 6(7).

19 Given this conclusion, the application judge regarded it as unnecessary to address ING's s. 28(1) PPSA argument. In contrast to its position on this appeal, ING did not rely on s. 25(1) of the PPSA in the proceeding before the application judge.

**II. Issues**

20 I would frame the issues on appeal this way: do ING's salvage rights in the Trucks have priority over GE's pre-existing perfected PMSIs in the Trucks and their proceeds by operation of: (i) s. 4(1)(c) of the PPSA and statutory condition 6(7) of the Insurance Act; (ii) s. 28(1) of the PPSA; or (iii) s. 25(1) of the PPSA?

**III. Analysis**

21 GE advances two main arguments in support of its claim that its PMSIs have priority over ING's salvage rights. It submits that the application judge erred by concluding that the combined operation of s. 4(1)(c) of the PPSA and statutory condition 6(7) of the Insurance Act resulted in title to the Trucks vesting in ING free from GE's perfected PMSIs in the Trucks and their proceeds. GE also asserts that neither s. 28(1) nor s. 25(1) of the PPSA are engaged in this case since, in the case of s. 28(1), the Transfer was not a "[sale] in the ordinary course of business" and, in the case of s. 25(1), GE did not expressly or impliedly authorize the Transfer. I will address these arguments in turn.

22 To begin, I note that the issues on appeal relate to the interpretation of the relevant PPSA provisions and statutory condition 6(7) of the Insurance Act. The process of statutory interpretation is governed by the modern rule of statutory construction, first described in E.A. Driedger, *Construction of Statutes*, 2nd ed. (Toronto: Butterworths, 1983) at p. 87:

> Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.

See also: Ruth Sullivan, *Sullivan and Driedger on the Construction of Statutes*, 4th ed. (Toronto: Butterworths, 2002) at pp. 1-3; *Bell ExpressVu Ltd. Partnership v. Rex*, [2002] 2 S.C.R. 559 (S.C.C.), at para. 26; and *Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 S.C.R. 27 (S.C.C.), at para. 21.

***(1) Section 4(1)(c) of the PPSA and Statutory Condition 6(7) of the Insurance Act***

23 The application judge concluded that the combined effect of s. 4(1)(c) of the PPSA and statutory condition 6(7) of the Insurance Act was to deprive GE of the priority protection otherwise afforded to its PMSIs under the PPSA. With respect, I disagree.

*(i) PPSA regime*

24 The PPSA is provincial chattel security legislation designed to protect the rights of creditors and debtors by regularizing secured transactions in personal property. To achieve this objective, the PPSA establishes a province-wide, notice-based registration system. Under this system, the first creditor to register notice of a security interest in a debtor's personal property generally has a first priority secured interest in that property that is effective against third parties, including other secured creditors: see *1231640 Ontario Inc., Re*, 2007 ONCA 810 (Ont. C.A.), at para. 4 *per* Weiler J.A. (in dissent, but not on this point), leave to appeal to S.C.C. granted, (S.C.C.). The purpose of such legislation was described by Gonthier J. (dissenting on other grounds) in *Royal Bank v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411 (S.C.C.), at para. 21:

> [P]rovincial legislatures have moved to protect secured creditors generally through the enactment of personal property security legislation ... These statutory regimes have been implemented to increase certainty and predictability in secured transactions through the creation of a coherent system of priorities ... The benefits of such certainty in commercial transactions, on basic economic principles, are intended to accrue to the health of the economy in general.

25 Section 2 of the PPSA delineates the scope of the statute:

> Subject to subsection 4(1), this Act applies to,
>
> (a) every transaction without regard to its form and without regard to the person who has title to the collateral that in substance creates a security interest including, without limiting the foregoing,
>
> (i) a ... conditional sale ... and
>
> (ii) an assignment, lease or consignment that secures payment or performance of an obligation;

Thus, under s. 2(a) and subject to s. 4(1), the PPSA applied to GE's security interests in the Trucks, as created under the CSAs.

26 The central priorities rule under the PPSA is set out in s. 9(1): "*Except as otherwise provided by this or any other Act*, a security agreement is effective according to its terms between the parties to it and against third parties" (emphasis added).

27 In this case, GE's PMSIs in the Trucks were perfected by registration under the PPSA before the issuance of the ING policies and the Transfer. As a result, under the s. 9(1) priorities rule, GE's PMSIs have priority over the interests of all third parties with a subsequently acquired interest in the secured collateral. The issue, therefore, is whether s. 4(1)(c) of the PPSA and statutory condition 6(7) of the Insurance Act, alone or in combination, constitute an exception to the s. 9(1) PPSA priorities rule, such that ING's salvage rights in the Trucks overtake the priority of GE's PMSIs in the same collateral.

*(ii) Section 4(1)(c) PPSA exclusion*

 

28 Section 4(1)(c) of the PPSA excludes transfers of "an interest or claim in or under any policy of insurance" from the application of the PPSA. Jacob S. Ziegel and David L. Denomme, in *The Ontario Personal Property Security Act: Commentary and Analysis*, 2nd ed. (Toronto and Vancouver: Butterworths, 2000) at p. 82, citing F.M. Catzman, Q.C., *Personal Property Security Law in Ontario* (Toronto: Carswell, 1976) at p. 35, explain the rationale for the s. 4(1)(c) exclusion in this fashion:

> The drafters of the original Ontario Act rationalized the exclusion of security interests in insurance policies on the ground that the insurer maintains records of title and claims to policies and contracts issued by it and that there was no need for a separate registry.

See also *Rektor, Re* (Ont. Bktcy.), at para. 11.

29 Thus, the purpose of s. 4(1)(c) is to avoid the unnecessary duplication of notice systems concerning transfers that create interests or claims in or under insurance policies. This is achieved by excluding such interests or claims from the PPSA notice and registration scheme. Simply put, notice under the PPSA is not required to perfect a security interest falling within the ambit of s. 4(1)(c).

30 In *Stelco Inc., Re* [2005 CarswellOnt 1537 (Ont. C.A.)], 2005 CanLII 13192, this court was concerned with whether an assignment of unearned premium under an insurance premium financing contract came within the s. 4(1)(c) exclusion. Justice Weiler, writing for the court, examined the scope of s. 4(1)(c) and noted that its purpose is to exempt certain items of commerce from the notice and registration requirements of the PPSA. She commented, at paras. 10, 15, 21-22 and 24:

> [Section] 4(1)(c) deals specifically with transfers of interests or claims in insurance policies. It does not deal with "other items of commerce" and these are not exempted [from the application of the PPSA].
>
> .....
>
> The wording of the exclusion in s. 4(1)(c) is clear and should be read as including the assignment of unearned premium under a policy of insurance.
>
> .....
>
> *In Ontario, interpreting s. 4(1) as exempting [the premium financier] from registering its right to receive any unearned insurance premium leads one to s. 138 of the Insurance Act* [which provides for notice of an insured's assignment of the right to refund of premium under a contract of insurance].
>
> This is not to say that s. 138 gives [the premium financier] the right to priority over other secured lenders. To determine priorities, resort to the common law or to the provisions of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 would be necessary and that issue awaits another day.
>
> .....
>
> [The premium financier] has an interest in the unearned premiums that were transferred to it by virtue of the [contracts in issue] and ... *that security interest was exempt from registration by virtue of a combination of s. 4(1)(c) of the PPSA and s. 138 of the Insurance Act.* [Emphasis added.]

31 The effect of s. 4(1)(c) in this case, therefore, was to relieve ING of the obligation to protect its interests under the ING policies by providing notice of those interests in the PPSA registry. But s. 4(1)(c) did no more. It did not relieve ING of the requirement to be mindful of the PPSA-protected interests of secured creditors. Nothing in the language of s. 4(1)(c) suggests that it is intended to resolve priority disputes between creditors, including priority competitions between a creditor with a perfected security interest under the PPSA (like GE) and a creditor whose interest in collateral is exempt from the notice and registration requirements of the PPSA (like ING).

32 Indeed, a consideration of the language of s. 4(1)(c) in the context of its purpose indicates that s. 4(1)(c) is not concerned with priorities at all. The words of Professors Ziegel and Denomme at p. 116 of their above-cited text, although addressing another exclusion from the PPSA under s. 4(1)(a), apply with equal force to s. 4(1)(c):

 

> [Section] 4(1)(a) means not only that the Act has nothing to say about the creation and perfection of non-consensual security interests but also that *it does not regulate priorities between PPSA security interests and non-PPSA interests.* [Emphasis added.]

33 Accordingly, since s. 4(1)(c) of the PPSA does not address priorities, it does not operate to oust the priority otherwise conferred on GE's PMSIs by s. 9(1) of the PPSA.

34 This conclusion is bolstered by the nature of the transaction at issue. GE submits that s. 4(1)(c) does not apply to resolve the priority contest between the parties because the Transfer did not "in substance create a security interest" in or under an insurance policy or amounts payable under an insurance policy. Thus, it is contended that the Transfer did not fall within the ambit of s. 4(1)(c). I agree.

35 Section 4(1)(c) of the PPSA is modelled after Article 9 of the Uniform Commercial Code (the "UCC"), which establishes exceptions from similar personal property registration schemes in the United States. UCC 9-109(d)(8) provides:

> 9-109(d) This article does not apply to:
>
> > (8) a transfer of an interest in or an assignment of a claim under a policy of insurance...

36 Prior to July 1, 2001, the wording of UCC 9-104(g) — the predecessor provision to current UCC 9-109(d)(8) — was identical to that of s. 4(1)(c) of the PPSA. The ambit of UCC 9-104(g) was interpreted by American courts as limited to direct interests created in an insurance policy by making the policy itself the collateral securing the transaction in question. Thus, for example, in *Paskow v. Calvert Fire Insurance Co.* (1978), 579 F.2d 949 (U.S. C.A. 5th Cir.), 953 (5th Cir. 1979), the court explained that UCC 9-104(g) was "directed not at the insurance of collateral but the creation of a security interest *in an insurance policy*" (emphasis added). See also *PPG Industries v. Hartford Fire Insurance Co.* (1976), 531 F.2d 58 (U.S. C.A. 2nd Cir.), 60 (2nd Cir. 1976).

37 The Transfer in this case was not a secured transaction — it did not create an interest that secured payment or performance of an obligation. Nor did it create a security interest "in or under an insurance policy", including in respect of amounts payable under an insurance policy, so as to trigger the application of s. 4(1)(c) of the PPSA. Rather, it involved the purported transfer of ownership in the Trucks to ING in exchange for full indemnification under the ING policies on the basis of a total loss claim.

38 I note that GE makes no claim to the ING policies or their proceeds. Its claims are to the collateral secured by the CSAs — the Trucks — and, in the case of the 2005 Truck, to the proceeds of sale realized by ING, in respect of which GE holds PPSA-protected security interests. GE's claims, therefore, are unaffected by s. 4(1)(c). Its claims are based on "PPSA security interests" in the Trucks and, in respect of the 2005 Truck, in its proceeds. In contrast, ING's interests in or under the ING policies and its salvage rights in the Trucks are "non-PPSA interests".

39 In all these circumstances, I agree with GE's submission that s. 4(1)(c) does not operate in this case to determine the priorities between GE's PPSA security interests in the Trucks and their proceeds and ING's non-PPSA salvage rights in the Trucks. Section 4(1)(c) simply has no bearing on that key issue.

40 However, that does not end the matter. In the application judge's view, it was the combined operation of s. 4(1)(c) and statutory condition 6(7) that determined this priority contest. Recall that he held that GE's interest in the vehicles, "is not protected by the PPSA for the reason that [the] PPSA does not apply to a transfer of an interest under a policy of insurance" and "There was such a transfer of an interest by virtue of Statutory Condition 6(7)." I turn now to consideration of statutory condition 6(7).

*(iii) Statutory condition 6(7)*

41 Under s. 234(1) of the Insurance Act, statutory condition 6(7) forms part of the standard form automobile insurance policy in use in Ontario.[2] Statutory condition 6(7) is concerned with automobile total loss cases. In such cases, an insurer is

  

entitled to the salvage, if any, in the lost automobile where it elects to replace or pay the actual cash value of the automobile. In *McNaughton Automotive Ltd. v. Co-operators General Insurance Co.* (2005), 76 O.R. (3d) 161 (Ont. C.A.), at para. 54, leave to appeal to S.C.C. refused, [*Woods Estate v. ING Halifax Insurance Co.*] (2006) (S.C.C.), this court explained that statutory condition 6(7) affords an insurer three options where an insured vehicle is a total loss:

> First, the insurer can replace the insured's car and take title to the salvage. It is entitled to the salvage because otherwise, its insured will be over-indemnified. Second, it can pay the actual cash value of the car and take title to the salvage. Again, the insurer claims entitlement to the salvage to prevent over-indemnification. Third, it can elect to leave the salvage with the insured, in which case the insured's loss would not be the actual cash value of the car but its diminution in value.

42 In this case, the Trucks were lost through theft. On proof of loss, ING exercised the second option described in *Polowin* — it paid Brampton and the third party lessees the actual cash value of the Trucks, less applicable deductibles, in exchange for the Transfer. Having satisfied its indemnity obligations under the ING policies in full, ING became entitled under statutory condition 6(7) to title to any salvage in the Trucks. But this does not mean that statutory condition 6(7) operates to vest title to the salvage in ING, free and clear of pre-existing perfected security interests in the Trucks. I say this for several reasons.

43 First, the concepts of priority and salvage are not the same. Statutory condition 6(7) does not refer to priorities, the interests of secured creditors, or the PPSA. It refers to the right to salvage in respect of a total loss insured vehicle. A plain reading of statutory condition 6(7) offers no support for ING's contention that it is intended, alone or in combination with s. 4(1)(c) of the PPSA, to extinguish a creditor's pre-existing perfected security interest in a vehicle that becomes the subject of a total loss claim. For example, statutory condition 6(7) does not contain the words "notwithstanding any security interest in the vehicle". It is, of course, open to the legislature to create a right that extinguishes or subordinates the pre-existing perfected security interests of third parties. But if this were the intent of statutory condition 6(7), it could easily have been accomplished by the use of explicit priorities language.

44 This conclusion is fortified by the decision of the Supreme Court of Canada in *Sparrow*. In that case, Iacobucci J., writing for a majority of the court, confirmed at paras. 106 and 112, that clear and unambiguous language is required to extinguish the rights of a secured creditor in respect of collateral:

> Parliament has shown that it knows how to assert priority over rival security interests ... All that is needed to overtake a fixed and specific charge is clear language to that effect.
>
> Finally, I wish to emphasize that it is open to Parliament to step in and assign absolute priority to the deemed trust. A clear illustration of how this might be done is afforded by s. 224(1.2) [of the *Income Tax Act*], which vests certain moneys in the Crown "notwithstanding any security interest in those moneys" and provides that they "shall be paid to the Receiver General in priority to any such security interest". All that is needed to effect the desired result is clear language of that kind. [Citations omitted.]

See also *First Vancouver Finance v. Minister of National Revenue*, [2002] 2 S.C.R. 720 (S.C.C.), at paras. 26-28; *DaimlerChrysler Financial Services (Debis) Canada Inc. v. Mega Pets Ltd.*, 2002 BCCA 242 (B.C. C.A.), at para. 38.

45 In contrast to the explicit Crown priority provision referenced in *Sparrow*, statutory condition 6(7) is devoid of any express or implied indicators of a legislative intent to affect the perfected security interest of a secured creditor in an insured vehicle that is lost to an insured. In my view, to read such an intent into statutory condition 6(7) in the absence of clear and unequivocal language evidencing such a legislative objective would constitute an unwarranted extension of the scope of an insurer's salvage rights.

46 Second, and importantly, statutory condition 6(7) represents a statutory codification of the common law right of subrogation. In *Polowin*, Laskin J.A., writing for a unanimous court, held at para. 82 that an insurer's right to claim salvage under statutory condition 6(7), "amounts to the exercise of the right of subrogation after fully indemnifying the insured for the insured's loss". He later added at para. 100: "Once an insured has been fully indemnified for the loss, the right to salvage is simply the exercise of the right of subrogation to prevent over-indemnification [of the insured]."

47 Subrogation is a derivative right that rests on the principle of indemnification. It contemplates that on full indemnification of an insured by an insurer for an insured loss, the insurer becomes entitled to exercise a right belonging to the insured. In *Insurance Law* (Toronto: Irwin Law, 2004), Denis Boivin states at pp. 280, 282 and 284:

> Subrogation arises when the insured has an enforceable right against someone other than his or her insurer — a right that would allow the insured to recover the losses caused by the peril, in part or in their entirety. Subrogation allows the insurer to enforce this right in the name of the insured and to withhold from the resulting award the equivalent of any indemnity paid under the insurance contract.
>
> . . . . .
>
> The insurer must be placed in the exact same position as the insured. The insurer must have access to *all* the rights and remedies of the insured with respect to the insured object ...
>
> . . . . .
>
> Subrogation is a derivative right — that is, it depends entirely on the rights of the insured.
>
> [Italicized emphasis in original; Underlined emphasis added.]

48 In other words, under the principle of subrogation, the insurer succeeds only to the exact right otherwise enjoyed by its insured. This is not a new proposition. It has long been recognized that under the right of subrogation, the insurer must be placed in the position of its insured. For this reason, the discussion in *Polowin* of an insurer's exercise of the right of subrogation under statutory condition 6(7) recognizes that prior to the insurer's election to trigger statutory condition 6(7), the right to salvage in an insured vehicle is a property right of the insured. Where, however, the insurer pays the insured's total loss claim in respect of the insured vehicle, it becomes entitled to all the salvage rights that the insured possessed in respect of the insured vehicle. Statutory condition 6(7), therefore, is concerned with an insurer's right to salvage as against its insured.

49 The application judge does not appear to have considered the implications of the principle of subrogation in the context of statutory condition 6(7). Instead, relying on *Giffen, Re*, [1998] 1 S.C.R. 91 (S.C.C.), he concluded that the dispute between GE and ING could not be resolved on the basis of the examination of Brampton's rights in respect of the Trucks or the determination of who has title to the vehicles, "because the dispute is one of priority to the vehicles and not ownership in them".

50 I agree that we are concerned here with the priorities as between GE's and ING's interests in the Trucks. I also agree that the question of title to or ownership of collateral is not determinative of priorities under the PPSA: see for example, *Giffen*, at para. 26. However, the pertinent issue is the reach of ING's rights under statutory condition 6(7).

51 Under statutory condition 6(7), where an insurer decides to replace or pay the actual cash value of a total loss vehicle, the salvage in the vehicle, if any, vests in the insurer by operation of law. Where, as here, the prerequisites to the invocation of statutory condition 6(7) are met, the issue is whether any salvage is in fact available for the benefit of the insurer. In some cases, no salvage will exist. For this reason, statutory condition 6(7) refers to salvage, "if any". Where salvage is available, the issue is whether the insurer's salvage right has priority over pre-existing perfected security interests in the vehicle in respect of which the salvage right arises.

52 Where — as here — salvage is available, the principle of subrogation that underlies statutory condition 6(7) and the requirement of indemnification on which that principle rests, mandate that an insurer who replaces or pays the actual cash value of an automobile in a total loss case steps into the shoes of the insured in relation to the right to salvage. The insurer is only entitled under the subrogation principle to the salvage right that was enjoyed by its insured prior to the insurer's decision to invoke statutory condition 6(7).

53 In this case, Brampton's interests in the Trucks were subject to GE's perfected PMSIs. Statutory condition 6(7) conferred on ING only those rights to salvage possessed by Brampton prior to ING's payment of the actual cash value of the Trucks. Absent

  

express statutory language to the contrary, statutory condition 6(7) should not be interpreted so as to confer on Brampton's insurer greater rights to salvage in the Trucks than were held by Brampton.

54 In other words, statutory condition 6(7) does not increase the rights of an insurer against third parties beyond those enjoyed by its insured, or create new rights in the insurer not previously possessed by its insured. The 'vesting' of salvage rights that occurs under statutory condition 6(7) involves the conveyance of salvage rights as between an insurer and its insured. That transfer may be subject to the interests of the insured's secured creditors.

55 This conclusion accords with both commercial and common sense. If ING's assertion of priority is accepted, it would mean that a debtor whose vehicle was subject to the perfected security interest of a secured creditor could defeat that interest by the simple device of purchasing automobile insurance on the secured vehicle. In the subsequent event of the total loss of the vehicle, the interest of the secured creditor could be extinguished, without recourse, at the unilateral election of the debtor's insurer. This result would offend the principle of subrogation. It would permit a debtor's insurer to enjoy greater rights in the insured collateral than the debtor itself possessed. This is not a reasonable result. It is, therefore, to be avoided unless a legislative intent to effect such a result is evident. No such intent is manifest in statutory condition 6(7).

56 The application judge relied on *Chrysler Credit Canada v. Fehr* (2001), 55 O.R. (3d) 630 (Ont. S.C.J.) for the proposition that an insurer's entitlement to salvage under statutory condition 6(7) "was exempt from a claim under the PPSA". In so doing, he adverted to the following passage from *Chrysler Credit*, at para. 11:

> The issue before me is not one of a transfer of an interest in a policy of automobile insurance. The issue before me does not include an insurer's right under [s. 6(7)] of the statutory conditions, which are incorporated in the policy, to acquire title to the salvage. Accordingly, the PPSA does not apply to the insurer's right to acquire the salvage of the collateral.

57 I acknowledge that many of the facts in *Chrysler Credit* are analogous to those in this case. However, *Chrysler Credit* is distinguishable from the case at bar in several pivotal respects. Unlike this case, *Chrysler Credit* involved a claim by a secured creditor for entitlement to the proceeds of an insurance policy on a destroyed vehicle after the debtor's insurer had paid the debtor for the vehicle loss. That is not this case. As I have emphasized, GE makes no claim to the proceeds of the ING policies.

58 Moreover, s. 258(3) of the Insurance Act was crucial to the decision in *Chrysler Credit*. That provision deals with the application of insurance money payable under an automobile insurance policy. It provides that an insured's creditor is not entitled to share in the insurance money payable under the policy unless the creditor's claim is "one for which indemnity is provided for by [the policy]". As there was no evidence that Chrysler Credit was a named insured or loss payee under the policy in question, it was precluded under s. 258(3) from claiming entitlement to the insurance proceeds and was restricted to its contractual rights against the debtor. Section 258(3) of the Insurance Act does not apply in this case, as GE seeks to obtain the secured collateral and proceeds from the sale of part of the secured collateral, rather than the proceeds of the ING policies themselves.

59 Finally, in my view, *Chrysler Credit* does not hold that an insurer's right to salvage has priority over a secured party's interests in the automobile that gives rise to the salvage rights. Rather, the passage from *Chrysler Credit* relied on by the application judge concerns the rights of an insurer, as against its insured, to obtain salvage rights in insured collateral. In that context, *Chrysler Credit* holds that s. 4(1)(c) of the PPSA does not apply to an insurer's salvage rights.

*(iv) Summary*

60 I would summarize my conclusions concerning s. 4(1)(c) of the PPSA and statutory condition 6(7) of the Insurance Act as follows:

> (i) Section 4(1)(c) and statutory condition 6(7) do not address priorities. To determine priorities in this case, resort must be had to s. 9(1) of the PPSA. Neither s. 4(1)(c) of the PPSA nor statutory condition 6(7) of the Insurance Act, alone or in combination, constitute an exception to the s. 9(1) PPSA general priorities rule. On the facts of this case, GE's PMSIs in the Trucks are effective as against ING under s. 9(1).

(ii) Under s. 4(1)(c), ING was relieved of the obligation to provide notice of its interests under the ING policies in the PPSA registry. However, while s. 4(1)(c) freed ING from the need to protect its own interests under the PPSA, it did not relieve it of the requirement to be mindful of the PPSA-protected interests of other parties in the same collateral.

(iii) The reach of ING's salvage rights under statutory condition 6(7) is determined by Brampton's salvage rights as they existed before ING triggered statutory condition 6(7). Brampton's salvage rights in the Trucks did not extinguish or displace the priority of GE's PMSIs in the Trucks and their proceeds. As against GE, therefore, ING is in no better position in respect of its salvage rights than was Brampton.

***(2) Section 28(1) of the PPSA***

61 ING argues that the Transfer was a usual transaction for a leasing company, with the result that it was a "sale" in the "ordinary course of business" by Brampton, within the meaning of s. 28(1) of the PPSA. Consequently, ING asserts, it took title to the Trucks under the Transfer free from GE's PMSIs. I again set out s. 28(1) of the PPSA:

> 28.(1) A buyer of goods from a seller who sells the goods in the ordinary course of business takes them free from any security interest therein given by the seller even though it is perfected and the buyer knows of it, unless the buyer also knew that the sale constituted a breach of the security agreement. [3]

62 I disagree for two reasons. First, I am not persuaded that the Transfer from Brampton to ING constituted a "sale" for the purpose of s. 28(1) of the PPSA. G.H.L. Fridman, Q.C., in his text entitled *Sale of Goods in Canada*, 5th ed. (Toronto: Carswell, 2004) notes at pp.11-12:

> At common law there appear to be instances in which property in goods is compulsorily transferred by the law from one person to another. *In such cases there is no purchase, the parties do not stand in the relationship of seller and buyer to each other, and there is no sale of goods. ... In such instances, there is no bilateral transaction which can be called a contract of sale*; nonetheless, the effect of what has happened is the transfer of property in goods from one person to another. [Emphasis added.]

63 These comments are apposite here. ING did not offer to buy and Brampton did not offer to sell the Trucks. No agreement of purchase and sale was entered into by the parties. Instead, ING's acquisition of title to the Trucks occurred in the context of an insurer's contractual relationship with its insured and the insured's loss payee, as a condition of Brampton's receipt of the cash value of the Trucks under the ING policies. Under statutory condition 6(7), ING became entitled to the salvage in the Trucks on its election to pay the actual cash value of the lost Trucks. Once ING so elected, its entitlement to its insured's salvage rights in the Trucks occurred by operation of law.

64 In these circumstances, to quote Professor Fridman, there was no "purchase", the parties did not "stand in the relationship of seller and buyer to each other", there was "no sale of goods", and there was no true "contract of sale" between ING and Brampton.

65 Second, even if the Transfer could be said to have constituted a "sale" for the purpose of s. 28(1), this record does not support the contention that the Transfer was carried out by Brampton in the "ordinary course of business", as required under s. 28(1).

66 The test for determining whether a transaction is a sale in the ordinary course of business is uncontroversial. It is a question of fact to be objectively assessed, based on all the circumstances of the particular case: *Bank of Nova Scotia v. Groupe Procycle Inc.*, [1999] O.J. No. 24 (Ont. Gen. Div. [Commercial List]), at para. 21; and *Fairline Boats Ltd. v. Leger*, [1980] O.J. No. 216 (Ont. H.C.), at para. 12. Several factors compel the conclusion that the Transfer was not a transaction carried out by Brampton in the "ordinary course of business".

67 The record shows that Brampton was in the vehicle leasing and rental business. There was no evidence before the application judge — and none has been adduced before this court — establishing that Brampton's business also included the sale of vehicles. The record is silent as to what Brampton did with its inventory of leased vehicles at the end of their lease terms. This gap in the evidential record distinguishes this case from those cases relied on by ING in which the nature of the debtor's business required it to revolve its inventory by selling vehicles to customers in order to retire the debtor's debts and continue its business.

68 ING has adduced fresh evidence indicating that Brampton was a registered dealer and salesperson with the Ontario Motor Vehicle Industry Council. The fact of this registration is not dispositive of whether Brampton's ordinary business actually included the sale of vehicles. It simply means that Brampton held the necessary registration to sell vehicles if it chose to do so. There is no evidence that it so elected or that the sale of vehicles was a necessary and commonplace, or even an occasional component of its day-to-day business.

69 The record also establishes that:

(i) Brampton did not own the Trucks;

(ii) Brampton did not market the Trucks to the public or to ING. On the contrary, the Transfer involved a compulsory acquisition by ING of title to the Trucks as a condition of payment under the ING policies;

(iii) ING was not a regular customer of Brampton;

(iv) the amount of the insurance proceeds paid by ING was not market-driven. Rather, it represented the cash value of the Trucks, which ING elected to pay as full indemnification under the ING policies; and

(v) the transfer of possession of the Trucks to ING was not a condition of payment of the ING insurance proceeds and there was no certainty that ING would ever obtain possession of the Trucks.

These are not the hallmarks of a sale conducted in the ordinary course of business.

70 Finally, Brampton obtained the ING insurance proceeds through misrepresentation. In the proof of loss forms submitted to ING, Brampton represented that no one held a security or other interest in the Trucks apart from the named insured under the ING policies. This was untrue. Thus, the Transfer in favour of ING and Brampton's receipt of the ING insurance proceeds were accomplished by dishonest means. Normal commercial dealings with inventory by a leasing company in the course of the company's ordinary and usual business do not proceed on this basis.

71 I would reject this ground of appeal.

***(3) Section 25(1) of the PPSA***

72 ING also argues, for the first time on appeal, that s. 25(1) of the PPSA prevents GE's PMSIs in the Trucks from attaching to the collateral in ING's hands. Again, I disagree. For convenience, I again set out s. 25(1):

**25.** (1) Where collateral gives rise to proceeds, the security interest therein,

(a) *continues as to the collateral, unless the secured party expressly or impliedly authorized the dealing with the collateral free of the security interest*; and

(b) extends to the proceeds. [Emphasis added.]

73 In *Secured Transactions in Personal Property in Canada*, 2nd ed., looseleaf, (Scarborough: Carswell, 2003) at para. 9.01, Richard H. McLaren makes the following observation regarding the effect of s. 25(1):

 

> The negative implication of [s. 25(1)(a)] is that if the secured party authorized the disposition, then the acquiring party will take free of the secured party's claim to the collateral. In effect, the security agreement ceases to operate as to the collateral.

74 ING accepts that GE's PMSIs extend to the proceeds of the Trucks. However, it submits that as the ING insurance proceeds were paid to Brampton, GE's claim for the proceeds must be advanced as a claim in Brampton's bankruptcy. ING also argues that GE's PMSIs do not "continue as to the collateral" within the meaning of s. 25(1)(a) because GE "expressly or impliedly authorized" Brampton to deal with the collateral: (i) by permitting Brampton to deal with insurance-related matters concerning the Trucks and to make insurance claims regarding stolen vehicles; and (ii) by classifying Brampton's vehicles as "inventory" in its PPSA registrations. I disagree.

75 GE did not expressly authorize Brampton to sell or otherwise dispose of the Trucks. Nor do I think that such authorization was impliedly granted. While it is true that the terms of the CSAs authorized — indeed required — Brampton to place and maintain insurance on the Trucks, they also obliged Brampton to name GE as a beneficiary under the requisite insurance policies, "under a broad form of Secured Creditor Endorsement Clause". In addition, the CSAs contained an explicit title reservation clause in favour of GE. Unless and until the full amount owing to GE had been repaid, title to the Trucks remained with GE.

76 These provisions of the CSAs, by which GE sought to protect its interests in the Trucks and to preserve its ownership of them until the amounts owing to it had been paid, belie the notion that GE authorized Brampton to dispose of the Trucks. On the contrary, until its payment obligations to GE had been satisfied, Brampton enjoyed only the right to quiet use and enjoyment of the Trucks for so long as it was not in default under the CSAs.

77 Nor, on the facts of this case, do I accept that GE's description of the Trucks as "inventory" in its PPSA registrations constituted an implied authorization to Brampton to deal with the Trucks in any manner that Brampton saw fit. There is no evidence that GE knew that Brampton was leasing the Trucks with a view to eventually selling or otherwise disposing of them, that this was Brampton's intention, or that the sale of leased inventory formed part of Brampton's day-to-day or even occasional business activities. Indeed, this does not appear to have been suggested by Brampton even in its dealings with ING. The ING policies provided for "permission to rent or lease" the Trucks.

78 I would not give effect to this ground of appeal.

***(4) Concluding Observations***

79 I end with these observations. This case involves the balancing of the competing interests in collateral of two 'innocent' parties. GE took all necessary steps to perfect its PMSIs under the PPSA. It had no knowledge that the Trucks had been stolen until its own inquiries led to discovery of the thefts. Nor did it know of Brampton's misrepresentations to ING. ING had no involvement in the thefts or Brampton's misrepresentations, and it did not know of GE's security interests in the Trucks until after it had paid the proceeds under the ING policies.

80 On the other hand, measures were available to both parties that might have avoided this dispute. GE did not require that Brampton cause its third party lessees to name GE as an insured, a loss payee or a beneficiary under any third party insurance policy obtained on the Trucks. Nor did GE require Brampton to provide it with copies of any third party insurance policies. These options were available to GE. However, their success was dependent on the reliability of Brampton and its lessees.

81 For its part, ING did not conduct any PPSA searches in this case. It defends this omission by pointing to what it describes as standard insurance industry practice: in reliance on s. 4(1)(c) of the PPSA, no PPSA searches are performed by insurers or insurance brokers prior to the issuance of automobile insurance policies. But, as I have said, the effect of s. 4(1)(c) of the PPSA is to relieve an insurer from the necessity of protecting its own interests in respect of an insurance policy by providing notice of those interests in the PPSA registry. Section 4(1)(c) does not insulate insurers from the PPSA-protected claims of third party secured creditors.

 

82 And the means of ascertaining the existence of GE's PMSIs in the Trucks were readily available to ING by the simple device of conducting a PPSA search before issuing the ING policies, before paying the ING insurance proceeds, before requesting and receiving the Transfer from Brampton and, in the case of the 2005 Truck, before disposing of the insured collateral. Notice of GE's security interests was also provided in the used vehicle information packages available from the Ministry of Transportation. ING did not avail itself of any of these opportunities to determine if its interests would be subject to the protected priority position of another claimant. Unlike the preventative options available to GE, which I have described above, the measures available to ING to protect its interests were not dependent on the reliability of its insured or a third party.

83 I note also that the potential existence of secured creditors with claims regarding the insured collateral was within ING's contemplation. The ING policies provided for the identification of lienholders and the protection of their interests on payment of the ING insurance proceeds. This record is silent as to what steps ING took, if any, to determine if secured claims existed in respect of the Trucks prior to settling Brampton's claim for indemnification under the ING policies.

84 In these circumstances, I view it as unreasonable that a creditor in GE's position should lose its priority in secured collateral because it failed to foresee that its debtor would actively mislead its involved insurers. To hold otherwise would impose a protectionist obligation on GE and similarly situated secured lenders that could undermine normal good faith collateral financings.

85 I therefore conclude that, as between GE and ING, the consequences of Brampton's misrepresentations must be borne by ING. It is ING, therefore, who must look to Brampton for satisfaction. This result is consistent with the proposition, which I endorse, that an insured or its named loss payee who has derived the benefit of an insurance policy, must make good to the insurer any loss occasioned to it by the insured's or the loss payee's lack of good faith or honesty.

**IV. Disposition**

86 I would allow the appeal, set aside the order of the application judge, and declare that: (i) GE's PMSIs in the Trucks and their proceeds have priority over ING's salvage rights in the same vehicles; and (ii) GE is entitled to possession of the 2003 Truck and to the proceeds from the sale of the 2005 Truck. I would award GE its costs of this appeal on the partial indemnity scale, fixed in the amount of $17,000, inclusive of disbursements and G.S.T., and its costs of the proceeding before the application judge, fixed — as agreed by the parties — in the total amount of $15,000, inclusive of disbursements and G.S.T.

***R.G. Juriansz J.A.*:**

I agree.

***J. MacFarland J.A.*:**

I agree.

*Appeal allowed.*

Footnotes

1 In the CSA and financing change statement pertaining to the 2003 Truck, the assignee and secured creditor are identified as GE Capital Canada Equipment Financing Inc., rather than GE Canada Equipment Financing G.P. The parties did not address this discrepancy on this appeal. I therefore assume that it reflects a name change in relation to the appellant and that nothing turns on this issue.

2 Section 234(1) of the Act states, in part: "The conditions prescribed by the regulations made under paragraph 15.1 of subsection 121(1) are statutory conditions and shall be deemed to be part of every contract to which they apply ..."

3 Section 28(5) of the PPSA extends the reach of s. 28 to include sales of motor vehicles out of the ordinary course of business in certain circumstances, unless the vehicle identification number (VIN) of the motor vehicle is set out in a registered financing or financing change statement filed under the PPSA, or unless the buyer knew that the sale constituted a breach of the applicable security agreement. ING does not suggest that s. 28(5) is engaged in this case. GE properly registered its interest in each of the Trucks under the PPSA, listing the VINs of each Truck in separate registrations.

End of Document



 

TRISURA GUARANTEE INSURANCE COMPANY -and- EBERSOLE EXCAVATING INC. et al.
Plaintiff Defendants

Court File No. CV-14-10766-00CL

***ONTARIO***
**SUPERIOR COURT OF JUSTICE**
**COMMERCIAL LIST**

PROCEEDING COMMENCED AT
TORONTO

**BOOK OF AUTHORITIES OF**
**MAYNARDS INDUSTRIES LTD.**
**(Distribution Hearing Returnable May 13, 2015)**


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