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THE FINANCING OF MOVEABLES: LAW REFORM IN QUEBEC AND ONTARIO

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Article abstract

De tous les domaines que le droit prétend réglementer, il s'en trouve peu qui posent autant d'embûches au réformateur que celui des garanties sur les biens meubles. La présente étude porte sur l'analyse de l'un des aspects fondamentaux de ce domaine : celui du financement commercial de biens meubles destinés à la fabrication et à la revente (à l'exclusion des achats de consommation). Notre raisonnement s'appuie sur une hypothèse qui soulève les points suivants : i) les rapports entre les garanties conventionnelles aux privilèges légaux; ii) l'usage de contrats de mise en gage; iii) les garanties de la créance du vendeur; iv) le rôle du financement par mode de comptes recevables; v) la nature juridique et les usages légaux du gage, d'après la Loi des pouvoirs spéciaux des corporations; vi) les effets de l'article 88 (le gage en vertu de la *Loi sur les banques*) au-delà des règles du droit civil. Nous devons nous rendre à l'évidence que le droit qui s'applique à ce domaine au Québec n'est généralement pas codifié. Il se fonde sur des présomptions périmées quant à la propriété mobilière. En outre, il semble ignorer l'importance d'une réglementation souple en matière de garanties sur les biens meubles, pourtant essentielle au maintien d'une saine économie commerciale. À notre avis, la structure juridique actuelle comporte plusieurs aspects négatifs : elle est trop complexe et trop technique; elle encourage le financement commercial par un prêteur unique; elle favorise le financement contre une seule garantie en ce qu'elle ne prévoit pas de mécanismes propres à faciliter l'établissement des priorités; elle défavorise nettement certaines catégories d'emprunteurs, en restreignant le financement des marchandises usagées, le refinancement des stocks existants et le financement manufacturier; elle incite à des artifices de contrats pour obtenir des garanties, rendant de ce fait difficiles et coûteuses la transformation et la distribution de biens grevés.

Nous en venons à la conclusion qu'il y aurait lieu d'adopter au Québec un système qui distingue des contrats les garanties sur les biens meubles, en les plaçant sur les mêmes assises juridiques, et qui normalise et réglemente les recours du créancier. Nous estimons néanmoins qu'avant d'entreprendre la réalisation d'un tel projet, il importe de satisfaire aux deux conditions suivantes : tout d'abord, mettre au point une méthode efficace d'enregistrement des garanties sur les biens meubles; ensuite, s'assurer que l'ensemble des juristes soit favorable à une telle innovation. L'expérience acquise dans les juridictions de common law s'avère pertinente à ces deux égards.

Il existe en Ontario un régime statutaire qui résout le problème posé en common law par l'existence de toutes ces garanties conventionnelles que sont le nantissement ou legage, le « mortgage » des biens personnels et la vente conditionnelle. Les dispositions de ce régime sont contenues dans le *Personal Property Security Act*, qui ne prévoit qu'une seule forme de garantie possible, soit ce qu'on appelle le « security interest » (la charge). Celui-ci peut être modifié par les parties de façon à répondre à toutes les exigences de garanties soulevées dans notre cas. Cette Loi prévoit en outre un système informatisé d'enregistrement des « charges », de même qu'un ordre de priorités pour la collocation des créanciers. À cela vient s'ajouter un système unifié de mise en application des « charges ». Ces deux systèmes prouvent leur utilité en ce qui concerne les droits garantis dont il est question dans notre étude.

Nous démontrons cependant que le système ontarien accuse également de sérieux défauts. À cet égard, le chapitre réservé au financement des matières premières dans le Personal Property Security Act mérite considération. Sauf quelques exceptions, la Loi ne réglemente pas les garanties non conventionnelles; dans le cas qui nous occupe, cette absence de réglementation soulève des questions de priorité difficiles à résoudre. D'autre part, cette Loi exclut expressément certains types de « charges » créés par des compagnies dans certaines circonstances. Cette lacune pose également des problèmes de priorité qu'il n'est pas facile de trancher. Enfin, la Loi ne peut outrepasser les priorités établies par le gouvernement fédéral à l'article 88 de la Loi sur les banques, ce qui, encore une fois, donne lieu à d'épineuses difficultés.

Nous terminons notre étude, abordée sous l'angle des deux systèmes juridiques, convaincus des mérites d'un régime souple et intégré de garanties sur les biens meubles, à l'exemple de celui de l'Ontario et de celui que l'Office de révision du Code civil a recommandé pour le Québec. Nous retenons cependant que le système ontarien soulève, à certains égards, de sérieux problèmes, dont les amendements proposés par l'Office de révision du Code civil ne tiennent pas compte et auxquels viennent au surplus s'ajouter d'autres problèmes. L'application minutieuse de tels projets d'amendement aux problèmes paradigmatiques se révèle extrêmement utile à la mise en évidence des points faibles et à l'identification de certaines limites auxquelles se heurte la réforme globale du droit. De tels exercices contribuent à mettre en lumière le rôle positif que peut jouer le droit en matière commerciale et l'urgence de l'enseigner et de l'apprendre d'une façon unifiée et pragmatique.

THE FINANCING OF MOVEABLES: LAW REFORM IN QUEBEC AND ONTARIO

par R.A. MACDONALD*
R.L. SIMMONDS**

De tous les domaines que le droit prétend réglementer, il s'en trouve peu qui posent autant d'embûches au réformateur que celui des garanties sur les biens meubles. La présente étude porte sur l'analyse de l'un des aspects fondamentaux de ce domaine: celui du financement commercial de biens meubles destinés à la fabrication et à la revente (à l'exclusion des achats de consommation). Notre raisonnement s'appuie sur une hypothèse qui soulève les points suivants: i) les rapports entre les garanties conventionnelles aux privilèges légaux; ii) l'usage de contrats de mise en gage; iii) les garanties de la créance du vendeur; iv) le rôle du financement par mode de comptes recevables; v) la nature juridique et les usages légaux du gage, d'après la Loi des pouvoirs spéciaux des corporations; *vi) les effets de l'article 88 (le gage en vertu de la* Loi sur les banques) *au-delà des règles du droit civil. Nous devons nous rendre à l'évidence que le droit qui s'applique à ce domaine au Québec n'est généralement pas codifié. Il se fonde sur des présomptions périmées quant à la propriété mobilière. En outre, il semble ignorer l'importance d'une réglementation souple en matière de garanties sur les biens meubles, pourtant essentielle au maintien d'une saine économie commerciale. À notre avis, la structure juridique actuelle comporte plusieurs aspects négatifs: elle est trop complexe et trop technique; elle encourage le financement commercial par un prêteur unique; elle favorise le financement contre une seule garantie en ce qu'elle ne prévoit pas de mécanismes propres à faciliter l'établissement des priorités; elle défavorise nettement certaines catégories d'emprunteurs, en restreignant le financement des marchandises usagées, le refinancement des stocks existants et le financement manufacturier; elle incite à des artifices de contrats pour obtenir des garanties, rendant de ce fait difficiles et coûteuses la transformation et la distribution de biens grevés.*

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SUMMARY

1. Introduction

1.1. General Outline of this Study

Few matters which the law purports to regulate have proved as intractable for the law reformer as the field of security on moveable property. There are at least four reasons for this. First, by definition moveables can move: one never knows absolutely which legal rules of which jurisdiction will apply to a given transaction; one never knows with certainty what rights a possessor may have in a moveable. Second, moveables are subject to transformation by manufacture and use: one never knows completely whose raw materials and whose labour produced a given object and in what proportion they contributed. Third, moveables are invariably the object of diverse commercial transactions: from manufacture through ultimate disposition to the user a moveable may be sold, resold, leased, subleased and pledged several times. Fourth, moveables are one of the basic commodities of a modern economy: regardless of the law's prescriptions, business will seek to use legal forms to accomplish commercial purposes; the law thus serves only the crudest channeling and structuring function in this area. It is not surprising, therefore, that the field of security on moveable property has been a source of great tribulation in most modern legal systems.

In this study we propose to examine one major aspect of the law of security on moveable property: the non-consumer financing of moveables for manufacture and resale. Because of the thousands of potential applications of legal rules in the area, we have decided to proceed through a systematic analysis of a specific hypothetical problem. This approach will focus our discussion and help avoid the overgenerality and miscomparison which sometimes afflict studies such as this. Of course, in order to keep our analysis manageable, the hypothetical problem we have drawn will be slightly simplified and, therefore, somewhat artificial. Nevertheless, it reflects a not inconceivable pattern of commercial financing and is not inappropriate as a chronology in either jurisdiction under review.[1]

Immediately below we set out the problem. After summary review of the principal features of the law we then show, in Part 2, how the problem raises several difficulties if the present law of

1. We find justification for this approach in STEIN, "Uses, Misuses — and Non Uses of Comparative Law", (1977) 72 *N.W.U.L. Rev.* 198, esp. 203-209, where the Watson/Kahn-Freund debate is reviewed.

Quebec is applied. Here we are not concerned to trace out particular solutions to the difficulties highlighted, but rather we wish to emphasize the theoretical interrelation of various security devices available to Quebec sellers and lenders. In Part 3 we examine the hypothetical problem from the perspective of the common law and recent legislative enactments such as the Ontario *Personal Property Security Act*.[2] In this part we are not as concerned to elaborate the theory of the system as we are to illustrate how specific difficulties would be resolved (or not resolved) in Ontario. In Part 4 we conclude with an overview of the Civil Code Revision Office Report and evaluate how well these proposals overcome the difficulties highlighted in the present law, as well as those which the Ontario reform has not eliminated. Finally, we draw some general conclusions about the possibilities for effective law reform in the area of security on moveable property, and offer a few suggestions for the use of the comparative method in the commercial law field.

1.2. A Hypothetical Problem in the Financing of Moveables

What follows is the hypothetical problem which will serve as the basis for all our subsequent discussion. We have separately identified each creditor and the security device he has employed.

(a) Westmount Widget Inc. is a widget manufacturer and wholesaler in the City of Westmount. It carries on business in a shop and warehouse which it rents under a lease in authentic form from Laurent Locateur for $7,000 per month.

(b) Widget Inc. was originally financed by a share issue as well as by bonds in the amount of $500,000 secured by a trust deed under the *Special Corporate Powers Act* dated January 1, 1979 and registered immediately. The deed stipulated a charge on all moveable property (including machinery), present and future and also contained an assignment of accounts receivable clause. There also was a clause prohibiting the granting of prior or *pari passu* security.

(c) In order to get the business going, and to establish a relationship with a financial institution Widget Inc. borrowed $100,000 from Better Bank, secured by a s.88 security agreement signed March 1, 1979, over all property capable of serving as security under s.88 (1) (b) of the *Bank Act*. The notice of intention to

2. *Personal Property Security Act*, R.S.O. 1970, c. 334 as amended by 1972, c. 1, s. 52; 1973, c. 102; 1976, c. 39 and 1977, c. 23.

grant security was properly completed and filed on January 15, 1979. Because start-up and machinery costs were underestimated, Widget Inc. found itself short of cash and on June 1, 1979, by notarial deed entered a Commercial Pledge with Friendly Finance for $50,000. The pledge deed specified the following equipment: saw, punch-press, boxing machine. It conformed to the provisions of the Civil Code and was properly registered on June 15, 1979.

(d) The machinery in the shop consisted of, *inter alia,* (i) a saw, purchased from Steven's Saws on a conditional sales contract dated February 1, 1979, which is still not paid off, although the last payment was due April 1, 1980; (ii) a punch press, which Widget Inc. purchased from Peter's Punch Presses, Inc. on March 1, 1979, and which is also not completely paid for; (iii) a boxing machine which Widget, Inc. owns outright.

(e) Also on the premises are two tons of tempered steel produced and delivered on March 1, 1980, under a conditional sales agreement by True-Temper, Ltd. $20,000 remains due on this agreement. Another three tons of steel, delivered under the same contract, has been manufactured into 15,000 widgets. This process involves cutting and molding the steel and incorporating with it pre-fabricated plastic parts. The respective value of steel, plastic and labour in each widget is about 1/3 each. On May 1, 1980, Daniel Distributor, a retailer, purchased and took possession of 5,000 widgets, for which he agreed to pay $15,000. $5,000 has been paid on this account and remains in Widget, Inc.'s safe. $10,000 remains due. The 10,000 remaining widgets are stored in Widget Inc.'s warehouse.

(f) In order to move this inventory, loosen up his credit and engage in volume discounting, Widget Inc. sells its accounts receivable to Angrignon Acceptance as security for a loan of $150,000. The agreement is dated June 1, 1980. The agreement is subsequently properly registered and published under article 1571d of the Civil Code.

Assuming that the question arose on September 1, 1980, our analysis will evaluate the nature and extent of each creditor's security, and its relative priority on the moveable property of Widget Inc. We expressly avoid any discussion of the law of bankruptcy.

2. Financing Moveables in Quebec

The present legal framework for the financing of moveables in Quebec has been subjected to detailed juridical scrutiny and

criticism.[3] It is not the object of this part of our analysis to repeat these criticisms. Rather we are concerned to outline the salient functional characteristics of this framework, and by referring to the problem set out in the introduction, to illustrate some of the practical consequences of these characteristics.

2.1. Introduction

A discussion of this topic may begin profitably with a brief review of (i) the main sources of the present law of security on moveables, (ii) the formal characteristics of the present law, (iii) the assumptions about commerce which are revealed in the present law, and (iv) the obvious major consequences from a financing perspective which result from the present law.

A first observation which must be made is that, more than any other civil law topic, the legal framework as set out in the relevant articles of the Civil Code is an inadequate basis for understanding the financing of moveables in Quebec. There are three aspects to this inadequacy. First, because of deficiencies in the regime of security on moveables envisioned by articles 1980-2008 C.C. lenders and sellers have resorted to various "title transactions" as a means of protecting their interests. The most common of these involve conditional sales, sales with a right of redemption, sales with a leaseback, double sales, and sales of accounts receivable all regulated in sections of the Code dealing with Obligations, Sales and Lease. Second, the most comprehensive and flexible security device in Quebec law is regulated principally by the skeletal provisions of a separate statute, sections 27-33 of the *Special*

3. See, most notably CIVIL CODE REVISION OFFICE, *Report on the Quebec Civil Code*, vol. II, pp. 346-372; CARON, "L'article 9 du Code Uniforme de Commerce peut-il être exporté?", in ZIEGEL and FOSTER (eds) *Aspects of Comparative Commercial Law*, 1969, pp. 374-395; LeDAIN, "Security upon Moveable Property in the Province of Quebec", (1956) 2 *McGILL L.J.* 77; DESJARDINS, "Les garanties mobilières", (1971) 74 *R. du N.* 64; RENAUD, "Loi des pouvoirs spéciaux des corporations: deux régimes de sûretés?", (1972) 74 *R. du N.* 383; (1967) *Meredith Memorial Lectures, passim;* (1976) *Meredith Memorial Lectures, passim;* COMTOIS, "Le nantissement commercial", (1963) 9 *McGILL L.J.* 261; PAYETTE, "Le fiduciaire pour obligataires et l'avis de soixante jours", (1972) 74 *R. du N.* 412; PAYETTE, "Cession des créances en garantie", (1968) 3 *R.J.T.* 281; SMITH et RENAUD, *Droit québécois des corporations*, 1974, pp. 935-1026, 1046-1083; S. MARCOTTE, "Gage, nantissement commercial et *Loi des banques*", in *Cours de formation professionnelle du Barreau du Québec*, 1979-1980, titre XIV; DUNFORD, "Le Code civil et le crédit: the Point of View of the Creditor", in *Livre Centennaire du Code civil*, 1967, pp. 147-167; GOLDSTEIN, "The Quebec Law of Privileges or Alice in Wonderland Revisited", (1976) 22 *C.B.R. n.s.* 1.

Corporate Powers Act.[4] Although the *Act* incorporates fundamental civil law concepts such as hypothecate, pledge and cede and transfer, its scope transcends the limitations on these devices imposed by the Code. Third, the most powerful, although limited, security device available to lenders is created by a federal statute, the *Bank Act.*[5] Charaterization of the nature of the security available under this statute has proved extremely difficult in the civil law context as the rights of the lender defy assimilation into usual concepts such as ownership or pledge. For these reasons elucidation of this topic requires us to examine the interrelation of several juridical institutions neither contemplated by articles 1966-2008 C.C. nor easily integrated into the framework of security on moveable property established by the Code in those articles.

The salient legal characteristics of the present law can be traced to the limited conception of the nature, functions and elements of security on property in a dynamic commercial economy. In particular, the Code is preoccupied with organizing systems for priority of payment among various non-commercial and non-contractual claims rather than with establishing a mechanism for granting real security. It does not contemplate that a right to follow or trace is just as important in moveable financing as it is with respect to immoveables. By linking security to the fact of possession it denies a borrower capacity to manufacture goods over which he has granted security. While a form of non-possessory pledge is available under the *Special Corporate Powers Act* the lender's security over inventory is usually extinguished by alienation of the property by the borrower. In addition, the Code does not seem to recognize the pervasiveness of credit transactions and concomitantly, the value and importance of incorporeal rights such as book debts and credit contracts in financing arrangements. The question of proceeds from sale is not specifically regulated. Lastly, the Code is parsimonious in its allocation of creditor's remedies upon default. The judicial sale is clearly contemplated as the optimal way for a creditor to realize upon his security, although the *pacte commissoire* is permitted in certain pledge agreements. Each of the above aspects of the law reflects the limited conception of security on property in the present law and restricts the usefulness of the Code as a regulator of security devices.

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4. *Special Corporate Powers Act*, L.R.Q. 1977, c. P-16.

5. *Bank Act*, R.S.C. 1970, c. B-1, as amended. None of these amendments are, however, relevant to our discution. This article was written prior to the enactment of the new *Bank Act*. This new statute does not alter our analysis in any material respect.

The current framework of the law also reveals several assumptions about the nature of commerce which, while they may have been true in 1866, are no longer justifiable. Throughout, the Code is structured on the principle that moveables are of less value than immoveables (*res mobiles, res viles*) and that consequently, financing of the former is comparatively both inexpensive and less necessary. This seems tied to a belief that while consumers may need credit, commerce does not. Consumer credit can be assured through conditional sales or collateral guarantees such as a second hypothec; these are obviously impractical in the commercial sphere. The present law also reflects a belief that a multiplicity of independent security devices — privilege, pledge, documentary pledge, title transactions, floating charge — are a superior guarantee of suppleness in moveable financing to a unitary integrated security device. It is as if flexibility resulted from the deployment of an array of inconsistent mechanisms rather than from tailor-made security of a similar kind. In addition, one finds an overweening faith in freedom of contract between businessmen in that security under the *Special Corporate Powers Act* or by way of the pledge of book debts is left relatively unregulated. It appears that the Code considers commercial borrowers to be exempt from economic duress through adhesion contracts and unconscionable terms as to scope of security, conditions of default and creditors' remedies. Again, the present system assumes a uniformity of credit needs by commerce: short-term money; medium-term money; and long-term financing. The differing security devices they require are not contemplated. The idea that commercial enterprises put money they receive to different uses appears unacknowledged; while consumers borrow principally to finance durables (vacations excepted) businesses must finance equipment, inventory, their own credit arrangements, future expansion and the like. A final assumption is that rarely does business seek financing from more than one source; or at least, that rarely does business need to create successive security over the same goods in order to finance its operation. The multiplicity of registration systems and the inadequacy of the information provided make multiple financing hazardous. Of course, a law based on such assumptions encourages development of a "customary law", which, however, is often unwieldy and sometimes contrary to the Code provisions.

We conclude this introduction by noting some important practical consequences of the present system. First, it encourages one-lender financing. By failing to provide an adequate priorities and registration system, it would tend to induce lenders to

maximize security and insist on more guarantees than are reasonably required, including provisions that no subsequent security may be granted. Hence, borrowers in need of refinancing or additional credit are compelled to enlarge their indebtedness to existing creditors, usually at a higher rate, rather than to seek alternate sources of capital. Secondly, the present system encourages single-security financing. A multiplicity of devices are potentially available to creditors but these are ineffectually integrated. Moreover, because first-ranking creditors may preclude or discourage the subsequent granting not only of superior, but also of inferior-ranking security (either through granting title security or by express contractual provision) borrowers may often be compelled to give general security over equipment, land, inventory, materials, accounts receivable and intellectual property (or as much thereof as they can) to their first lender either under the *Bank Act* or the *Special Corporate Powers Act*. Third, certain categories of commercial borrower are placed at a severe disadvantage. While title transactions such as conditional sales may alleviate much of the problem for retail or wholesale financing of new inventory, the borrower who wishes to refinance existing inventory or finance used inventory must resort to complex and expensive devices such as double sales or field warehousing. Again, wholesale suppliers of raw materials must resort to the banks in order to finance operations with the inconveniences attaching to such security. Finally, manufacturers are in the same position and apart from the bank or receivables financing are unable to effectively grant security. Fourth, the absence of an integrated registration system (or of any system with respect to title transactions) leads to the use of title as a financing device and also complicates consensual agreements with lengthy default provisions and refinancing prohibitions. We shall return to each of these issues in Part 4.

2.2. The Legal Framework of the Problem

There is no shortage of general explicative literature on the various security devices which can be used to finance moveables in Quebec. In this section it is our intention merely to outline these devices in relation to the problem already presented, by identifying relevant legislative provisions and setting out how each will serve an explanatory purpose.

First we note, by reference to the claim of the lessor, that the system of consensual security on moveables is integrated with and subject to the plethora of legal privileges set out in the Code and special legislation. These simple priorities for payment often

compromise the effectiveness of a lender's rights and disrupt credit calculations by departing from a temporal theory of priorities. The lessor's claim is regulated principally by articles 1637-1640, 1994(8) and 2005 C.C.

Second, although we have not endeavoured to discuss simple pledge (as it is not frequent in commercial matters) we use the example of a commercial pledge to illustrate security over corporeal property by *quasi*-documentary pledge and documentary pledge. This departure from possessory security in corporeal moveables, but without an adequate system of publicity, and its assimilation to ordinary for purposes of priority, create inequities with respect to other possessory and non-possessory secured creditors. The rules of commercial pledge are set out in articles 1966-1979, 1979e-1989k, 1994(5) and 2001 C.C.

Third, we highlight the problem of securing a vendor's claim by emphasizing the limitations of the privilege accorded to ordinary sellers. By distinguishing unpaid vendors from conditional sellers we introduce the concept of security by title transaction as reflected in sales with a right of redemption, double sales and sales with a leaseback. This leads to a discussion of problems arising from the sale of a thing belonging to another and the effect of the rules of accession to moveables upon manufacturers. Theses issues are covered mainly by articles 429-441a, 1487-1490, 1543, 1546-1560; 1994(3) and 1998-2000 C.C.

The fourth creditor appearing in our problem is the assignee of book debts. Here we develop the importance of accounts receivable financing by distinguishing between the pledge of book debts and their sale. We also discuss how the law treats proceeds, how creditors may realize security on incorporeal rights, and formalities for the creation of security devices. Articles 1570-1578, 1966, 1994(4) and 2001 C.C. govern these cases.

Fifth, we discuss the rights of creditors holding debentures guaranteed by security under a trust deed. The distinction between fixed and floating charges is analysed. Other contractual rights such as the right of the trustee to take possession of the security are examined with a view to comparing creditors' remedies under various devices. Security on moveables by trust deed for bondholders is elaborated upon in sections 27-33 of the *Special Corporate Powers Act* as well as in articles 1966-1979 C.C., by incorporation.

Finally, we draw attention to the security available to chartered banks. Here, our principal focus will be on the problems of integrating this security into the framework of the civil law. We

shall also use this device as a springboard for a discussion of problems created by multiple registration systems, by preclusive security devices and by conflicting priorities rules. Sections 86 and 88-90 of the *Bank Act* elaborate the special security available to chartered banks.

Of course, in a discussion of this nature it is impossible to illustrate the full range of possibilities contemplated by the law of Quebec. The examples chosen reflect, however, major features of the present system respecting integration, priorities, remedies and notice. We emphasize that since our topic is consensual security in the financing of moveables, our discussion must be in large measure hypothetical: parties may by contract import a great variation in their financing arrangements, especially with respect to conditional sales, pledge of book debts, trust deeds under the *Special Corporate Powers Act* and security under the *Bank Act.*

2.3. Non-Consensual Priorities for Payment — the Privilege of the Lessor

Almost every legal system provides for a panoply of non-consensual charges and preferences for payment upon moveable property. Quebec is no exception. We have selected the claim of the lessor[6] as representative although the privilege for law costs, municipal taxes, fishermen, lumbermen and theatrical workers, as well as various statutory privileges in favour of the Crown, or its agencies[7] would also illustrate the effect of these preferences on the financing of moveables. The coverage of the lessor's privilege is established by articles 1637-1640 C.C. These articles provide that the privilege attaches to four categories of property: moveable effects found on the premises that belong to the lessee (1637 C.C.), sub-lessee (1638 C.C.) and third parties in certain cases (1639 C.C.), and certain moveable effects of the lessee after they have been removed from the premises (1640 C.C.).[8] It is the third and fourth

6. See generally, FARIBAULT, *Traité de droit civil du Québec,* tome XII, 1951; LANGELIER, *Cours de droit civil,* tome 5, 1907; MIGNAULT, *Droit civil canadien,* tome 7, 1906; SNOW, *Landlord and Tenant,* 3rd ed., 1934; ROUSSEAU—HOULE, *Précis du droit de la vente et du louage,* 1978. We note that proposed amendments to the Civil Code abolishing the lessor's privilege will not apply to commercial leases.

7. See *e.g. Ministry of Revenue Act,* L.Q. 1972, c. 22, s. 12 as amended by L.Q. 1978, c. 25, s. 5.

8. It should be observed that the usual interpretation given to the expression "moveable effects" in article 1637 C.C. is more restricted in scope than the

categories which are of special importance to the financer of manufacturing, wholesaling and retailing operations.

Article 1939 C.C., which extends the lessor's privilege to the property of third parties, nevertheless extinguishes this claim if the goods are on the premises without the consent of the owner, or if they are there only temporarily or accidentally, or if the lessor has knowledge of the rights of third parties. It is this notice exception which is particularly relevant to conditional sellers,[9] equipment lessors,[10] subsequent purchasers and documentary pledgees, but not as we shall see, the claim of a bank.[11] Although article 1639 C.C. speaks of the lessor otherwise becoming aware of third party rights, in the absence of written notice or an admission by the lessor, it is almost impossible to prove such knowledge.[12] Moreover, the contents of the notice must be relatively specific as to property included.[13] In our problem, the bank could give notice of its interest through delivery of the security agreement. Similarly, with respect to the conditional sale or lease of equipment and machinery, prior service of the contract upon the lessor ought to be sufficient. However, in the case of a conditional sale of raw materials or inventory this notice requirement becomes difficult to respect. Where there are multiple deliveries under successive supply contracts, unless individual shipments are separately warehoused until paid for, the seller may be unable to prove that remaining goods are in fact those not yet paid for. Since the lessor's privilege may also attach to goods sold and paid for as long as these remain in the rented premises, unless the lessor is notified of third party rights his claim subsists. Once again, separate warehousing of goods for shipment may be sufficient to protect a purchaser as long as the goods can be separately identified. The significance of express notice to

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expression "moveable property" and excludes incorporeal moveables such as money, book debts, rights of action, and other claims. It does encompass, however, equipment, materials and inventory which are our main concern here. Neverthess, a textual argument based on articles 395 and 397 C.C. could be erected in order to include incorporeals.

9. *Vachon* v. *Area Pecal Inc.*, (1971) R.P. 27.

10. *North America Business Equipment* v. *Terminal Towers Corp.*, (1972) C.A. 416.

11. *In re Alfandri; Grobstein* v. *Peel Street Realties Ltd.*, (1957) C.S. 448; *Re Fermo's Creations*, (1970) 10 D.L.R. (3d) 560 (Que. C.A.).

12. *Motiograph Inc.* v. *Champion Lanes*, (1963) B.R. 953; proof of knowledge is difficult even if written notice is given unless this is served or sent by registered mail. See *Rasikoff* v. *Papineau*, (1969) B.R. 763.

13. See *supra*, f.n. 10, where an equipment lessor was held not to have given adequate notice.

the extinction of this privilege is emphasized by Trudel, J. in *Morin* v. *Paquin.*[14]

A second important effect of the lessor's privilege upon contractual security arises because, unlike many legal preferences, the lessor has a limited right to follow goods once they have left the rented premises. Article 1640 C.C. states that the privilege subsists for fifteen days following removal if the goods remain the lessee's property.[15] Thus the property of prior conditional sellers, equipment lessors and banks is exempted from the lessor's privilege immediately upon its removal from the leased premises, notwithstanding any lack of notice to the lessor under article 1639 C.C. Similarly cash or ordinary credit buyers from the lessee extinguish the lessor's claim as soon as they take delivery of goods purchased. However, retail purchasers under conditional sales agreements may see their property subjected to the lessor's claim for fifteen days following delivery. Equally, wholesalers and manufacturers who buy under conditional sale may find their inventory subject to seizure by their supplier's lessor for up to fifteen days.

A third kind of difficulty for moveable financers illustrated by the lessor's privilege is that relating to the scope of legal preferences. While article 2005 C.C. suggests that the privilege only secures rent due or to become due and specifies the relevant period of attachment, article 1639 C.C. states that the privilege exists to secure the lessor's *rights*. In *Escomptek Harold Ltée* v. *C.T.C.U.M.*[16] the Court of Appeal recently decided that the privilege thus garanteed all of the lessor's rights under the law or the lease, including the right to compel eviction and to seek damages for breach of any terms in the lease. Consequently, lenders are put in the position of not being able to calculate even the maximum amount of the lessor's potential claim.

The final point to note with respect to the lessor's privilege is the question of rank or priority. Article 1994(8) establishes the rank of the lessor's privilege, except as modified by articles 1979h(2), 2000(2) and 2005a C.C. Under the Civil Code priority for payment is determined by law and cannot be established by parties to a security

14. *Morin* v. *Paquin*, (1968) R.P. 332. See also *Enterprise Saillant et Fils* v. *Louis Côté*, (1974) C.S. 380 for an equally restrictive view of notice.

15. See *Aetna Factors Corp.* v. *Brouillard*, (1976) C.P. 405 where goods were seized by another creditor within 15 days and the lessor was collocated. See also *Congregation du très Saint-Rédempteur* v. *Rooney*, (1979) J.E., no 79-161 (C.S.M.).

16. *Escomptek Harold Ltée* v. *C.T.C.U.M.*, (1979) J.E., no 79-1016 (C.A.M.).

agreement. Moreover, priority follows the nature of a claim and not the date the claim arises. Finally, in almost every case, such priority arises without publicity and without registration. Hence, while the lessor's privilege is in principle inferior to both that of an unpaid vendor and a pledgee under article 1994 C.C., it always outranks that of a trustee for bondholders.[17] Moreover, if an unpaid vendor falls within the conditions of article 2000(2) C.C. or if a commercial pledgee fails to give the lessor actual notice of his pledge see (1979h(2) C.C.) the lessor will outrank these other creditors. We have already seen that a lessor without notice outranks even an owner and persons assimilated to owners such as persons holding documentary pledges. Moreover, article 2005a provides that if an owner who has given notice does not oppose the seizure and sale of his property, his right to the proceeds passes after that of the lessor. The Code thus envisions in certain cases priority advantages for those who have legal privileges even as against owners, vendors and prior secured lenders who have no notice and no convenient means for acquiring notice of such claims.

Consideration of the lessor's privilege highlights several negative features of the non-consensual priority for payment framework of the Civil Code. This framework creates problems for prior secured lenders with respect to the nature and extent of their risk (*i.e.* which creditors have priority, on what items and to what extent). It induces creditors to resort to title security in the attempt to protect their rights, and imposes unrealistic notification burdens upon suppliers of raw materials and stock. It limits the power of manufacturers and retailers to pass ownership unencumbered by other than expressly constituted claims. Finally, due to the absolute non-existence of formalities for their creation and publicity inventory financers are compelled to undertake a continual, detailed and costly supervision of their debtors in order to protect their rights.[18]

2.4. Ordinary Contractual Security — Pledge Creditors

As noted earlier the basic theory of consensual security on moveables in Quebec is tied to the fact of possession. Hence, simple pledge was the only security available to a lender under the old Civil

17. *Special Corporate Powers Act*, L.R.Q. 1977, c. P-16, s. 29 (2).

18. See CIVIL CODE REVISION OFFICE, *op. cit.*, f.n. 3, 353-372 for a detailed critique of legal privileges.

Law.[19] Yet, for obvious commercial reasons manufacturers, wholesalers and retailers usually must be in possession or capable of obtaining immediate possession of the property over which they have given security. Creditors therefore began to resort to devices such as equipment leases, double sales, sale with a right of redemption and field warehousing in order to finesse the requirement of dispossession essential to pledge, and leave the borrower with access to the collateral.[20] The first three of these will be discussed in section 2.5 while field warehousing (an example of a transaction known as documentary pledge), and commercial pledge (a recent legislative innovation)[21] will be examined here. The former device is most appropriate for the financing of materials and inventory, [22] while the latter is, by its very framework, restricted to financing equipment and machinery. We have used the commercial pledge as illustrative of non-possessory pledge devices since the financing problems which arise in both cases are essentially similar.

According to article 1979e C.C., which sets out the substantive limits on commercial pledge, a person carrying on a commercial business may pledge his equipment and machinery as security for a loan made to him while still retaining possession of these goods. This possibility represents, of course, a radical departure from the rules of simple pledge, which saw dispossession by the debtor as the essence of the contract.[23] Article 1979e also provides that the commercial pledge is restricted to a term of ten years and may be entered into only to secure a loan of money. In a recent case, *Letang* v. *Poirier*[24] the Court noted that since commercial pledge was in

19. LeDAIN, *loc. cit.*, f.n. 3, 77-89.

20. For a discussion of some of these devices, see JOHNSTON, "Lease and Equipment Trust Agreements", (1967) *Meredith Memorial Lectures* 1 and SAUNDERS, "Pledge, Commercial Pledge, Sale with a Right of Redemption and Similar Security Devices", (1967) *Meredith Memorial Lectures* 16.

21. See SAUNDERS, *loc. cit.*, f.n. 20, and COMTOIS, "Une nouvelle législation: le nantissement commercial", (1963) 9 *McGILL L.J.* 261.

22. See *The Bills of Lading Act*, L.R.Q. 1977, c. C-53; *The Bills of Lading Act*, R.S.C. 1970, c. B-6. The form of documentary pledge which arises with respect to book debts under 1966 (3) C.C. will be discussed in section 2.6.

23. The requirement of dispossession presumably was justified by the fact that creditors would not be misled into loaning money to an individual who seemingly was possessed of many moveables but who had, in fact, previously pledged these to another creditor. See *Rousseau* v. *Bélanger*, (1952) B.R. 772. Needless to say, devices such as equipment leasing, conditional sale or *Bank Act* security also leave a debtor in possession of moveables in which he has very little or no equity.

24. *Letang* v. *Poirier*, (1979) J.E., no 79-827 (C.S. Hull).

derogation from the ordinary rules of pledge its conditions should receive a narrow interpretation. As a consequence it found an agreement purporting to commercially pledge objects in order to secure their purchase price to be a contract of sale and not one for a loan of money. The result was the annulment of the attempted commercial pledge.[25] In addition, article 1979e requires that the objects pledged be machinery or equipment, thus excluding inventory, raw materials and book debts.[26] A further restriction on the objects which may be pledged arises because apparently only moveables are envisioned. Consequently equipment or machinery which has become immobilized either by nature or by destination may not thereafter be commercially pledged.[27] Nevertheless, if machinery which has been validly pledged later becomes immoveable by destination, article 1979h(1) C.C. permits the pledge to subsist.[28] These provisions raise the problem of determining when an object has become immobilized by nature or by destination. While courts have been relatively narrow in their view of the former[29] requiring some actual incorporation into an immoveable with consequential loss of identity, they have recently shown a tendency to read out of article 379 C.C. the requirement that the object be placed "for a permanency".[30] While a liberal approach may not restrict already constituted commercial pledges, it limits the use of this device by those who own both land and business, and may complicate security agreements under both the *Bank Act* and the *Special Corporate Powers Act*. The potential coverage of commercial pledge therefore may depend on the moment of its constitution[31].

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25. *Cf.* however *Simoneau* v. *Roy*, (1965) R.L. 193 and *Dauphin* v. *Bertin*, (1972) C.S. 532 where a conditional sale was validly novated into a loan of money guaranteed by commercial pledge; see also *In re 600 Belvédère*, (1965) C.A. 730 where a commercial pledge was validly granted to secure a pre-existing loan.

26. See *In re M. Filiault Co.*, (1971) C.S. 335; *In re F. Guay*, 15 C.B.R. 155.

27. See *In re Greenfield Park Lumber*, (1977) C.S. 504.

28. Such immobilization might occur either because the constituent becomes owner of the land, of the machinery, or of both, or because he decides to affix the pledged machinery for a permanency. Immobilization by nature is excluded under 1979h (1) C.C. because of the impossibility of detaching the machinery without doing serious physical damage to the reality in order to realize upon the security.

29. See *Mechanic Supply* v. *Hudon*, (1933) 71 C.S. 400.

30. See *In re Amedee Leclerc: Thibault* v. *DeCoster*, (1965) C.S. 266; MARUNCZAK, "Immobilization by Destination of Immoveable Industrial Machinery", (1966) 12 *McGILL L.J.* 330.

31. Presumably, machinery could be de-immobilized by sale to a third party creditor,

Because publicity by possession does not exist with respect to commercial pledge the Code sets out rather extensive formalities for the creation of and for publicity for this security. Article 1979f C.C. provides that the contract be notarized or signed before two witnesses. Furthermore, the objects pledged must be precisely described and their location specified. This requirement would seem to preclude the pledge of fungible machinery or equipment not yet in the debtor's possession,[32] although it should be possible to pledge an undelivered piece of machinery which has been individuated, by referring in the deed to its serial number or other identifying mark, and the eventual location of the machinery according to the terms of article 1979f(3) C.C. Leased equipment and that purchased under a conditional sale contract may also be pledged subject to the limitations set out in articles 1488, 1489 and 2268 C.C. [33] The Code also requires, in article 1979g C.C. that the deed be registered by deposit in the land registry office of the district in which the pledged goods are located for the purposes of article 1979f C.C. Once these formalities are completed the security is perfected against third parties.[34] Consequently, it may be set up against subsequent acquirers of the goods[35] as well as subsequent pledgees or commercial pledgees.[36]

Creditors' recourses upon default are set out in article 1979i C.C. and are limited to the right to seek delivery of the goods with a view to selling them pursuant to article 1671a C.C. and obtaining a preference on their price.[37] The *pacte commissoire,* permitted in

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followed by a resale by conditional sale which is later novated into a loan of money, guaranteed by commercial pledge.

32. *Accord,* COMTOIS, *loc. cit.,* f.n. 21, 265.

33. Article 1966a C.C. makes these provision expressly applicable to the contract of pledge. See *infra,* section 2.5.

34. Articles 2083, 2084 C.C. It is arguable that, even without registration, the pledge is still good against some third parties: its priority is devalued to rank only ahead of unsecured creditors. See article 2094 C.C.; *accord,* MARCOTTE, *loc. cit.,* f.n.3,78; *contra* SAUNDERS, *loc. cit.,* f.n. 20, 20.

35. See, for example, *Caisse populaire de Ste-Mélanie* v. *Coopérative de tabac laurientienne,* (1952) C.S. 21. It also may be set up against trustees in bankruptcy: *Société coopérative agricole de Plessisville* v. *Tardiff,* (1963) C.S. 658; *In re Mocajo Const. Inc.: Freed* v. *Rodrigue,* (1973) C.A. 509; *Société de crédit agricole de Plessisville* v. *de Cotret, (1970) C.S. 287.*

36. For commercial pledge, see *In re Bertrand: Trans-Canada Credit Corp.* v. *Savage,* (1967) C.S. 596; for ordinary pledge, the subsequent pledge takes subject to the prior registered right, by analogy.

37. *In re Mocajo Const. Inc.: Freed* v. *Rodrigue,* (1973) C.A. 509.

simple pledge, is expressly prohibited by article 1979k and by analogy sale otherwise than under 1671a C.C. is contrary to law.[38] Insofar as priorities are concerned the pledge creditor is ranked according to articles 1994(4) and 2001 C.C. He would rank below an unpaid vendor (subject to article 2000(3) C.C.) but above a lessor (subject to 1979h(2) C.C.) and prior to a trustee for bondholders, regardless of these creditors' respective dates of registration. As between competing commercial pledges it has been held that the date of registration determines priority;[39] as between a commercial pledgee and a simple pledgee an analogous answer would seem to be indicated.[40]

These observations permit of several conclusions. First, while commercial pledge is not permitted over inventory or proceeds, it is still the case that inventory financers under a trust deed or in certain cases under the *Bank Act* often take security over machinery and equipment as well: the commercial pledge is inequitable in relation to them and serves to increase the borrower's cost of money. Second, because this device is assimilated to pledge it creates problems of priority insofar as the pledgee's right to seek possession and his right of retention are concerned.[41] Again, its assimilation to sale (a title transaction) insofar as the property of another is concerned is only partly alleviated by the fact that objects covered are usually not traded by the pledgor.[42] A final noteworthy feature of the commercial pledge is the inadequate registration system which makes

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38. *Accord*, COMTOIS, *loc. cit.*, f.n. 21; SAUNDERS, *loc. cit.*, f.n. 20, 20.

39. *In re Bertrand: Trans-Canada Credit Corp.* v. *Savage*, (1967) C.S. 596. Article 1979g C.C. may create difficulty in the hypothesis where commercially pledged goods are moved to another district and subsequently pledged prior to the prior to the lapse of the 3 month renewal period for registration.

40. In cases of prior commercial pledge, one could analogize subsequent possession to registration and adopt the solution in *In re Bertrand*. As for a prior simple pledge, without dispossession it is null (*Traders Finance Corp.* v. *Landry*, (1958) B.R. 120) and with dispossession, the formalities of article 1979f C.C. put the commercial pledgee on notice of the prior claim.

41. See *Sous-ministre du Revenu* v. *Total Rental*, (1979) C.S. 840 (C.S.M.) where the court invoked article 1977 C.C. in favour of the Crown as against a trustee under a trust deed. See also PAYETTE, (1980) 40 *R. du B.* 337.

42. Nevertheless, article 2208 (3) C.C. extends the class of protected sales to "commercial matters generally". It is only because the courts have interpreted the registration of a commercial pledge as notice to all the world that subsequent purchasers or pledgees cannot be in good faith. It follows that the commercial pledge is not really a pledge, or a documentary pledge, but rather a form of hypothec on moveables.

tracking down this security next to impossible for subsequent lenders.[43]

These remarks lead to a brief consideration of inventory financing by documentary pledge through the vehicle of field warehousing, a device which has not found great favour among lenders.[44] Since legislation in Quebec on this point is of common law origin it is only necessary to highlight peculiarities of this device in the civil law context. The statutory provisions giving rise to this form of documentary pledge are the *Bills of Lading Act* of Quebec, the *Bank Act*[45] and the provisions of the Civil Code on factoring (articles 1735-1754 C.C.). LeDain reviews several differences between these two statutes and notes that the Quebec lender is often disadvantaged.[46] Nevertheless, under the Quebec statute the endorsee has a claim for payment which outranks even that of the unpaid vendor, while no such provision appears in the *Bank Act.*[47] Field warehousing under the *Bank Act* is facilitated by a liberal interpretation of who may issue such receipt, while courts have taken a narrow view of the term warehouseman in the Quebec statute, and seem to require a *bona fide* third party custodian who has actual and apparent control of the consigned goods.[48] Moreover, the early hostility of Quebec courts to the use of "trust receipts"[49] has effectively limited the scope of documentary pledge over inventory, except where goods of substantial value are involved and where immediate, continual yet variable access to consigned goods by the debtor is unnecessary. A final reason for the lack of

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43. For a critique of registration, see (1967) *Meredith Memorial Lectures.*

44. *LeDAIN, loc. cit.*, f.n. 3, 95-103.

45. *Bills of Lading Act*, L.R.Q. 1977, c. C-53; *Bank Act*, R.S.C. 1970, c. B-1, ss. 86-90.

46. For example, s. 87 of the *Bank Act* appears to be broader than articles 1735-1754 C.C. on factoring; s. 90(1) of the *Bank Act* permits security to be taken before, at the time of, or after the loan was contracted, while in Quebec, the debt and the security must be concurrent (section 5); the *Bank Act* contains no limit on the length of time goods may be held under a bill, whereas the Quebec statute limits such pledge to six months (section 5).

47. *Bank Act*, L.R.Q. 1977. c. C-53, s. 4. In effect this means that the consignee in Quebec will outrank all privileged creditors except tithes (which are inapplicable) and law costs. But see R.S.C. 1970, c. B-1, s. 89 (1), which protects the bank against certain unpaid sellers.

48. See cases cited by LeDAIN, *loc. cit.*, f.n. 3, 98-100, especially *La Banque Nationale* v. *Boyer*, (1911) 20 K.B. 341; *Payenneville & Martineau* v. *Prévost & Major*, (1916) 25 K.B. 246. *Cf. Bank Act*, R.S.C. 1970, c. B-1, s. 2 (1) "warehouse receipt".

49. *La Banque Molson* v. *Rochette*, (1888) 14 Q.L.R. 261 (S.C.); 17 R.L. 139 (C.A.). See critique by LeDAIN, *loc cit.*, f.n. 3, 100-101.

popularity of field warehousing can be traced to the widespread use of trust deed security under the *Special Corporate Powers Act,* which does not require a formal dispossessory mechanism for its perfection. Nevertheless, it is our opinion that where the circumstances are favourable (volume, value, limited access requirement) a properly drafted documentary pledge agreement respecting warehouse receipts can be an effective device for obtaining security over materials and inventory (especially in view of the respective priority for payment of assignees of warehouse receipts and trustees for bondholders).[50]

2.5. Purchase Money Security — the Claim of Vendors

Within the framework of purchase-money security the Code envisions two distinct categories of sellers, only one of which is entitled to the epithet " unpaid vendor".[51] In the first place, a seller may sell under a suspensive condition, retaining title to property sold until full payment of the purchase price. We shall refer to this creditor as a conditional seller. Second, the seller may sell outright, transferring title to the buyer according to the provisions of articles 1025 and 1026 C.C. If a seller passes title and possession of the property without payment of his claim in full, he will be an unpaid vendor, and may, in certain cases avail himself of three distinct rights.[52] He may seek a resolution of the sale under article 1543 C.C. and revendicate the goods; he may revendicate the goods without seeking resolution in order to perfect his right of retention under articles 1998, 1999 C.C.; or he may seize the goods and exercise a preference upon the proceeds of judicial sale under articles 1998-2000 C.C.

The right to have the sale resolved is subject to two important limitations.[53] First, in the case of insolvency the right may be

50. Compare *Bills of Lading Act,* s. 4; *Special Corporate Powers Act,* s. 29.

51. See generally, FARIBAULT, *Traité de droit civil du Québec,* tome XI, 1951; MIGNAULT, *Droit civil canadien,* tome 7, 1906; LANGELIER, *Cours de droit civil,* tome 5, 1907; POURCELET, *La vente, 1975;* ROUSSEAU-HOULE, *op. cit.,* f.n. 6.

52. If by contrast the seller transfers title upon a cash sale but retains possession he may exercise a rights of retention until payment (see articles 1496-1497 C.C.) or he may consider the sale resolved in certain cases (article 1544 C.C.).

53. This right is independent of any rights under articles 1998-2000 C.C. and is not subject to any of the restrictive conditions there imposed. It results from the application of articles 1532 and 1065 C.C. See *Re Beatrice Pines: Vendôme* v. *Laurence,* (1968) C.S. 351.

exercised only within 30 days of delivery (article 1543(2) C.C.).[54] Secondly, the goods must remain in the possession of the buyer. This requirement has been interpreted to mean juridical as opposed to *de facto* possession.[55] Hence, this right perishes as against the holder or consignee of a bill of lading,[56] banks holding a pre-existing section 88 security,[57] a donee (subject to article 1034 C.C.) or any purchaser, whether or not the price has been paid by him,[58] but probably not as against persons whom the buyer has put in simple detention on his behalf such as repairmen.[59] A final aspect of this question arises in the case of manufacturers. It has been held with respect to inventory that the object need not remain in the same condition as long as it may be clearly identified.[60] It is our view that problems of admixture by manufacture can be resolved by applying principles analogous to the rules of accession to moveables.

The unpaid vendor also may revendicate the goods in order to perfect his right of retention under articles 1496-1497 C.C. Nevertheless, articles 1998-1999 C.C. place several restrictions on this right which are even more onerous than those applicable to article 1543 C.C. It is necessary that the sale not have been made on credit, that the goods be entire and in the same condition, that they not have passed into the hands of a third party who has paid for them, and that the recourse be exercised within eight days of delivery (30 days in the case of insolvent traders).[61] The conditions mean that revendication is not possible on goods sold 30, 60 or 90

54. See, on the meaning of delivery, *Péladeau Lumber* v. *Universal Wood Products*, (1928) 34 R.J. 122.

55. *Pagnet* v. *Plamondon*, (1954) R.L. 223 (C.A.).

56. *Moss* v. *Banque de St-Jean*, (1887) 15 R.L. 353 (B.R.); *Toussig* v. *Baldwin*, (1894) 6 C.S. 119.

57. *Bock et Tétrault* v. *Fonderie L'Islet*, (1971) C.S. 379.

58. MIGNAULT, *op. cit.*, f.n. 51, tome 7, p. 148; POURCELET, *op. cit.*, f.n. 51, 140.

59. A difficult question arises with respect to persons holding titles translative of property, such as conditional buyers or buyers under a rights of redemption. In such cases there is probably sufficient dispossession to extinguish the first seller's right to have the sale resolved. A similar solution should avail with respect to pledgees, although the case of lessees is more complex.

60. In *Brown* v. *Labelle*, (1886) 2 M.L.R.C.S. 114, the court held that a mixture of inventories did not extinguish the seller's rights if his goods were still identifiable. Similarly, the fact of immobilization by destination alone would not extinguish the seller's rights.

61. ROUSSEAU-HOULE, *op. cit.*, f.n. 6, 146-147; POURCELET, *op. cit.*, f.n. 51, 138-139.

days net,[62] nor on objects which have been manufactured,[63] nor on goods which have been resold,[64] including apparently the case where a bank holds a pre-existing section 88 security,[65] or a creditor is the endorsee of a bill of lading.[66] Once the goods have been revendicated the seller may avail himself of article 1544 C.C. and treat the sale as resolved *de plano*.

The third privileged right of an unpaid vendor is to claim a preference upon the proceeds of the sale of the object. This preference is regulated by articles 1994(3) and 2000 C.C. which subject its validity to the same four preconditions as the right to revendicate.[67] In such cases the seller will rank above all other financing creditors having a preference on the proceeds except the

62. There is some unreported authority that goods sold "net 30 days" with a 2% discount for payment within ten days are sold on credit. See also *Fiducie du Québec* v. *Fabrication Précision Inc. et al.*, (1978) C.A. 255.

63. Most cases on this point deal with whether a moveable has become immoveable by destination, in which case the right to revendicate perishes. See, *Meruse* v. *Beaubien*, (1966) B.R. 413. If one manufactured object is attached to another, following this reasoning it is likely to be held not to be in the same condition. If raw materials have been transformed or incorporated into a new object this right similarly disappears. Finally, in contrast to article 1543 C.C. the right perishes (even before manufacture) if, for exemple, lumber is sawn, fabric is cut, steel is riveted etc. since the objects are no longer entire or in the same condition. See, however, the interesting case *Roy* v. *Bois Ste-Lucie Inc. et al.*, (1977) C.S. 845 where the Count found sawn lumber to be "in the same condition" as the logs from which it was sawn. This result is open to question.

64. Hence revendication is possible against donees, lessees, pledgees etc. Futher, it would exist against purchasers in bad faith (*Liakas and Son Fur* v. *Rothman*, (1965) R.P. 275), purchasers who have not paid the sale price and even purchasers who, having paid the price, have not taken delivery.

65. See *In re Eastern Wood Corporation*, (1975) C.S. 539; *In re Paramount Leather Goods*, (1959) C.S. 42. Although these judgments may seem to suggest priority to the bank in virtue of article 1999 (3) C.C. it is our opinion that the goods have not "passed into the hands of a third party". The bank's priority arises because of section 89 (1) of the *Bank Act*. Hence, if the bank takes security on goods sold and delivered within the preceding eight days, the bank's priority depends on knowledge with it may have of the vendor's claim. *Contra*, MARCOTTE, *loc. cit.*, f.n. 3, 82.

66. Endorsement of the bill of lading vests the endorsee with all the right and title of the endorser, which in this hypothesis extinguishes the vendor's claim. See also section 4 of the *Bills of Lading Act*.

67. The seller who brings a resolutory action under 1543 C.C. or proceedings in revendication under 1999 C.C. or an action upon the price may seize the property before judgment to protect his rights (*Sichelschmidt* v. *Nikel Industries*, (1976) C.S. 142).

bank and documentary pledgees.[68] However, if the seller has given credit such as "net 60 days", or if he exercises his rights later than eight or thirty days after delivery, as the case may be, his preference is also ranked after that of the lessor or pledgee (article 2000(3) C.C.) In other words, as long as the property has not passed into the hands of third parties who have paid for it, and as long as it remains in the same condition[69] the unpaid vendor has a preference on its price. Finally, even if the vendor fails to notify his buyer's lessor of the sale, his claim will outrank that of the lessor if he is within the eight or thirty day delay.[70]

These limitations on the right of unpaid sellers to revendicate property, to achieve priority over banks, documentary pledgees, lessors and ordinary pledgees or to retain security upon subsequent sale of the property have produced the situation where most sales of material and inventory in which the seller suspects the ability of the buyer to pay are on a conditional sale basis.[71] This device arises out of the ordinary law of suspensive conditions in contracts (articles 1079-1088 C.C.). Such agreements usually have a variety of standard clauses respecting default, acceleration, transfer of title, assignment of claims and creditors' recourses.[72] For the purposes of sales financing, the key element of this device is that *vis-à-vis* third parties the vendor remains owner. Subject to the extinctive rules relating to accession to moveables, prescription, and the sale of a thing belonging to another, he may resist seizure and revendicate the property from such third parties. Moreover, since the Code contains no requirement for registration or otherwise publicizing the fact of a conditional sale other financers may be misled as to the extent of the security they may take in a debtor's property.[73]

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68. *Bank Act*, s. 89 (1); *Bills of Lading Act*, L.R.Q. 1977, c. C-53 s. 4.

69. There is an obvious mistake in the English version of 2000 (2) C.C. where the phrase "in the same condition" is used. Clearly what is meant is "in the same *conditions* for revendication". See the French text, "dans les mêmes conditions".

70. Ownership is in the lessee. Hence, article 1639 C.C. does not apply and one applies the order established by article 1994 C.C.

71. See generally MACKAY, "Conditional Sale Contracts", (1967) *Meredith Memorial Lectures* 8. In this discussion we are not, of course, dealing with any matters which would fall under the *Consumer Protection Act*.

72. The most usual additional clauses are (i) a waiver of the buyer's rights against the seller upon assignment of the contract, and (ii) a right of the seller to take possession of the property without legal process upon default, and to resell privately the seized goods.

73. Only the lessor without notice has a claim on property sold under a conditional sale prior to the condition being realized (article 1939 C.C.).

Because of the favourable treatment which the Code affords to title security for sellers, commercial lenders have also attempted to employ title transactions to secure their claims.[74] In articles 1546-1560 C.C. an express model for such devices, sale with a right of redemption, is set out. In this contract the seller (borrower) reserves the right to reacquire ownership of the property (either moveable or immoveable) upon reimbursing the purchaser (lender) the purchase price and the cost of the sale. Although the Code seems to contemplate that the purchaser will ordinarily take possession of the object sold[75] there is no reason he need do so, even with respect to moveables.[76] For several years, however, Quebec courts took a narrow view of such sales where no possession was transferred,[77] but recently seem to have accepted their validity as long as the seller (borrower) is under no obligation to repurchase at the end of the term.[78] On the other hand, if a contract which purports to be a sale with a right to redemption is in reality a disguised pledge without dispossession (in that the seller must repurchase the property) it will not be held effective against third parties in the absence of actual dispossession.[79] Consequently, one may conclude that *true* sales with a right of redemption, sales followed by a conditional resale, sales with an option to repurchase, and the like may be used by lenders to achieve security by way of title on property remaining in the borrower's possession. These devices, nevertheless, remain somewhat risky in view of the inconsistent jurisprudence on the subject.[80]

The use of title security by way of conditional sale or sale with a

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74. See LeDAIN, *loc. cit.*, f.n. 3, 89-95; SAUNDERS, *loc. cit.*, f.n. 20, 21-25; POURCELET, *op. cit.*, f.n. 51, 151-162; ROUSSEAU-HOULE, *op. cit.*, f.n. 6, 163-172.

75. See articles 1546 (2) C.C. where the Code states that the seller cannot have possession, but compare 1547, 1550 C.C. which clearly talk of title rather than possession.

76. *Stewart* v. *Leblanc*, (1951) C.S. 237; *Bélanger* v. *Desjardins*, (1929) 32 R.P. 317; *de la Duantaye* v. *Cité de Québec*, (1929) 67 C.S. 128; *St. Abin* v. *Crevier*, (1919) 56 C.S. 143; *Laurin* v. *Lafleur*, (1897) 12 C.S. 381; *Salvas* v. *Vassal*, (1897) 27 S.C.R. 68. See also MIGNAULT, *op. cit.*, f.n. 6, tome 7, p. 157; POURCELET, *op. cit.*, f.n. 51, 154; *La Compagnie d'Assurance sur la Vie "La Sauvegarde"* v. *Ayers*, (1938) S.C.R. 1964; SAUNDERS, *loc. cit.*, f.n. 20, 23-24.

77. LeDAIN, *loc. cit.*, f.n. 3, 91-95.

78. See *I.A.C.* v. *Marmette*, (1957) B.R. 861; *Lemaire* v. *Tourville*, (1952) C.S. 221.

79. *Marmette* v. *Villeneuve*, (1968) B.R. 841; *Traders Finance Corp.* v. *Landry*, (1958) B.R. 120.

80. See SAUNDERS, *loc. cit.*, f.n. 20, 25.

right of redemption provides the secured party with a powerful guarantee in the event of default. In the manufacturing and wholesaling context, however, it raises several difficulties respecting the borrower's ability to pass title to subsequent purchasers. Understanding this security thus requires an analysis of the rules of accession to moveables and of the rights of true owners in the case of sales of a thing belonging to another. This is not the place for an attempt to disentangle these tortuous subjects.[81] Nevertheless, a general outline of each may be given. With respect to the sale of the thing belonging to another in commercial matters,[82] (a) insofar as raw materials, inventory and equipment (i.e. corporeal moveables) are concerned, (i) if the property is bought in good faith from a trader dealing in similar articles, and is neither lost nor stolen, article 2268(3) C.C. totally extinguishes the owner's right to revendicate the property; (ii) if the property is bought in good faith from a trader dealing in similar articles, but is lost or stolen (invariably the case where there is security by way of title transaction)[83] the owner may revendicate the property until prescription is acquired, but only upon paying its price (articles 1489, 2268(4) C.C.)[84]; (iii) if the property is bought in good faith but not from a trader dealing in similar articles and is neither lost nor stolen, article 2268(3) C.C. operates to extinguish the owner's right to revendicate; (iv) if the property is bought in good faith, not from a

81. A thorough treatment of the latter may be found in CARON, "La vente et le nantissement de la chose mobilière d'autrui", (1977) 23 *McGILL L.J.* 1, 280. It should be noted that articles 1488, 1489 and 2268 C.C. are made applicable to pledge by virtue of article 1966a C.C.

82. See PERRAULT, *Traité de droit commercial*, tome 1, 1940, no 286 ff. CARON, *loc. cit.*, f.n. 81, 5-19 reviews the jurisprudence in detail and concludes that commercial matter" should be given a wide interpretation to include sales between businessmen, sales by a businessman to a non-businessman, and sales by a non-businessman to a businessman. Moreover, he notes that "commercial matter" includes contracts other than sale such as pledge, giving in payment and occasionally, exchange. Consequently, all transactions falling within the scope of our discussion would be "commercial matters".

83. See CARON, *loc. cit.*, f.n. 81, 26-39. Following *I.A.C.* v. *Couture*, (1954) S.C.R. 34; *Sauvé* v. *The Guildhall Insurance Co.*, (1961) B.R. 733 and *Commercial Credit Corp.* v. *Royal Insurance Co.*, (1969) B.R. 793, it appears that "stolen" will always include conversion. Hence, in the absence of a factoring arrangement or the consent of the seller, the resale of an object sold on a conditional sale will always constitute a theft for the purposes of 1489 and 2268 C.C.

84. Although 2268 (3) C.C. speaks of dispossession of the owner, this has been taken to mean juridical dispossession. Hence, the three years would run only from the time a good faith buyer acquires property sold under conditional sale from the conditional buyer. See *Rickner* v. *Picard*, (1945) C.S. 432.

trader dealing in similar articles, but is lost or stolen, the owner may revendicate the property until prescription is acquired, but only upon paying its price (article 2268(4) C.C.); if the buyer is in bad faith, the owner may revendicate without reimbursement until his rights are extinguished by the thirty year prescription period;[85] (b) insofar as accounts receivable and other incorporeal rights are concerned the rules are slightly different: (i) if the property is bought in good faith not from a trader dealing in similar articles the owner may always revendicate for thirty years regardless of whether it is lost or stolen without reimbursement (article 2268 C.C. speaks only of corporeals); (ii) if the property is bought in good faith, from a trader dealing in similar articles, and it is neither lost nor stolen, the owner may revendicate it for a period up to thirty years without reimbursement (article 2268 C.C. speaks only of corporeals); (iii) if the property is bought in good faith from a trader dealing in similar articles, but it is lost or stolen, the owner may revendicate it for a period of thirty years, but only upon paying its price (article 1489); (iv) if the buyer is in bad faith, the owner's right to revendicate without reimbursement is prescribed by thirty years. It should be noted that these protective rules of articles 1488-1490, 1966a and 2268 C.C. are strictly interpreted, and do not apply to non civil code title transactions, for example in favour of creditors under the *Bank Act* or the *Bills of Lading Act*.[86] By contrast, these articles have been applied, notwithstanding S. 89(1) of the *Bank Act,* to subsequent purchasers of goods over which a bill of lading or a section 88 security has been granted.[87]

Applying these rules to ordinary manufacturing and wholesaling operations would usually lead to the following consequences. The seller or buyer who retains title will lose his right to revendicate the property without having to reimburse the buyer (i) if he has renounced this right generally in the original agreement, or specifically in certain resales; (ii) if the property is purchased in good faith (however the seller may revendicate upon paying the price for a period of three years). Of course, certain transactions

85. Excepting, of course, the thief himself or his successors, by universal title, who are prohibited from ever prescribing by articles 1268, 2197 and 2198 C.C. This also applies to incorporeals (articles 2197, 2198 C.C.).

86. CARON, *loc. cit.*, f.n. 81, 412-413. Hence, the endorsee of a bill of lading or the bank holding a section 88 security cannot invoke these rules against prior owners. This position is confirmed by L.R.Q. 1977, c. C-53, s. 1 (2); R.S.C. 1970, c. B-6, s. 2; R.S.C. 1970, c. B-1, s. 86 (2), 88 (2).

87. *A.-G. Canada* v. *Mandigo*. (1965) B.R 259; *Provincial Bank* v. *Dionne*. (1957) C.S. 167.

such as commercial pledge or the sale of incorporeals must be registered and in such instances it is rare that the buyer could be in good faith.[88] It follows therefore that while title security will generally afford the creditor priority *vis-à-vis* other financers, the rules of 1488-1490 and 2268 C.C. will deprive him of his security against most subsequent acquirers of the property.

The seller or lender who takes title security may also find his interest expropriated by the operation of the rules of accession to moveables (articles 429-441a C.C.).[89] Of course, this issue will not arise with respect to wholesale and retail inventory financing, but only with respect to the financing of raw materials for manufacture or components for assembly. Problems arising from assembly are those of adjunction and are contemplated by articles 430-433 C.C. which provide that (i) the owner of the principal thing expropriates the accessory, or (ii) the owner of the more valuable thing expropriates the less valuable, or (iii) if neither is principal and their values are nearly equal, the owner of the bulkier expropriates the less bulky. While these articles apply only to union of two objects they are extended by analogy to cases of multiple ownership (article 429 C.C.) [90] Problems arising from manufacture are principally those of specification and are resolved by articles 434-436 C.C. which provide that (i) the owner of the materials expropriates the worker's labour, except (ii) if the value of the workmanship greatly exceeds that of the materials it is the manufacturer who expropriates, and (iii) if the workman also employs his own materials, but his labour is of less value than the material of the third party the resulting object is *prorated* as to ownership. In this latter case there is both adjunction and specification.[91] Problems arising from mixing of inventories and raw materials are those of admixture and are dealt with in articles 437-438 C.C. which provide that (i) if the goods may be identified, they be divided, or (ii) if they may not that owners share *prorata,* or (iii) if one owner's material is far superior in value, he expropriates the other.[92]

88. See *In re Mocajo Const. Inc.: Freed* v. *Rodrigue,* (1973) C.A. 509 on the effects of registration of a commercial pledge.

89. See MONTPETIT & TAILLEFER, *Traité de droit civil du Québec,* tome 3, 1945, pp. 188-212; MIGNAULT, *Droit civil canadien,* tome 2, 1896, pp. 518-528.

90. The articles were obviously drafted before huge assembling machines were in use. Hence, *at any given moment* only two objects could be united.

91. For several examples, see *Gagnon* v. *Morin,* (1942) C.S. 361; *D'Auteuil Lumber* v. *Chassé,* (1937) 77 C.S. 54; *Therrien* v. *Royal Bank,* (1941) 79 C.S. 368.

92. See *B. & S. Lumber* v. *Michaud,* (1923) 35 B.R. 68 on mixed log booms.

In the commercial sphere these rules produce the following consequences.[93] The conditional seller or title financer of goods subject to adjunction or specification is exposed to expropriation in most cases, either by other conditional sellers or by the manufacturer; he is also exposed to expropriation in some cases of admixture. In other cases, his title will be preserved as a co-owner, and he may seek licitation of the property (article 439 C.C.). These rules are obviously inconvenient in a commercial economy and parties often renounce by contract their claims to accession.[94] Nevertheless, these rules may often find application with respect to the proceeds upon judicial sale of partially manufactured or partially assembled products. In the case of unused inventory or untransformed raw materials, absent admixture, the conditional seller may revendicate according to the ordinary rules.

The examination of purchase money security has shown the weaknesses of the current law with respect to unpaid sellers and has demonstrated why sellers and lenders attempt to have recourse to title security. Yet retention of title is a cumbersome financing device, and leads to problems respecting the sale of a thing of another and accession to moveables. Moreover, when the rules of 1488-1490, 2268 and 429-441a C.C. expropriate the owner's rights, he is left with no security on property whatsoever.

2.6. Accounts Receivable Financing — the Pledge and Sale of Book Debts

In a modern commercial economy the separate financing of accounts receivable usually takes one of two forms: these are either sold or assigned outright, or they may be pledged as security for a loan.[95] Because the Code assimilates for many purposes the pledge and the sale of receivables, it is necessary to discuss the sale of book debts prior to examining their pledge. Although article 1570 C.C.

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93. Article 440 C.C. will rarely find application in commercial matters since goods presumably are delivered in order to be assembled or manufactured.

94. MIGNAULT, *op. cit.*, f.n. 89, 519 feels that the rules of 429-441a C.C. are of public order for judges, but does not consider the case oif private stipulation by parties.

95. See generally, TAVISS, "Accounts Receivable, Section 88 of the Bank Act and Inventory Financing", (1967) *Meredith Memorial Lectures* 44; MARCOTTE, *loc. cit.*, f.n. 3, 72-75; PAYETTE, "Cession de créance en garantie", (1968) 3 *R.J.T.* 280; FARIBAULT, *Traité de droit civil du Québec*, tome 11, 1959, pp. 459-494; POURCELET, *op. cit.*, f.n. 51, 171-186; ROUSSEAU-HOULE, *op. cit.*, f.n. 6, 180-190; DESMEULES, "La vente des créances", (1965) 1 *C. de D.* 172; PAYETTE, "Clauses de transport de loyers", (1968) 71 *R. du N.* 511.

provides that, as between parties, the contract is consensual and is perfected either by completion of a notarized deed or delivery of the deed if under private writing,[96] articles 1571 ff. C.C. impose certain formalities for its validity against third parties. First, it may be set up against account debtors upon whom the deed is served.[97] However, articles 1571c and 1571d C.C. relax this formalism in certain cases. The former permits notice of the sale of a universality of debts to be achieved through deposit of a copy of the deed in the office of the prothonotary for the district of the account creditor's place of business, followed by newspaper publication as set out in article 1571a C.C. The latter permits notice of the sale of present and future accounts receivable of a commercial enterprise to be effected by registering the deed in the registry office of each division where the account creditor has a place of business.[98] Second, if the debtor accepts the assignment, either at the time of or subsequent to the act of sale, it may be set up against him.[99] In conditional sales to consumers such an acceptance of assignment clause usually appears on the contract itself, usually accompanied by an attempted waiver of recourse against the assignee.[100] Such "factoring" or discounting of "chattel paper" is of course, common only at the retail level.[101]

The non-debtor third party effects of assignments commence on the date of notice (either by signification or registration under 1971d C.C.) or acceptance under 1971 C.C., while the assignment is perfected against the debtor from the date of service or acceptance (articles 1570, 1572 C.C.)[102] or newspaper publication following

96. *Traders Ltd.* v. *Commercial Credit Co.*, (1974) C.A. 247.

97. *A.-G. Canada* v. *Irving Oil*, (1975) C.S. 665. If a privileged or hypothecary claim is ceded, an additional registration under article 2127 C.C. is required.

98. See *Chomedy Asphalt Ltée: Provincial Bank* v. *Hébert*, (1969) C.S. 308. *In re Immeubles Westgate Inc.: Fafard* v. *Royal Bank*, (1976) C.S. 893 the court specifically held that only accounts originating in the division(s) for which registration had been effected could be set up against third parties.

99. *J. Cohen (1962) Inc. v. Rothstein*, (1971) C.S. 705.

100. Such attempts are now unlikely to succeed in light of the *Bills of Exchange Act*, R.S.C. 1970, c. B-5, s. 188-192, and *The Consumer Protection Act*, 1978, ss. 102, 103.

101. Article 1574 C.C. attaches accessories or guarantees to the assignment (subject to article 2127 C.C.) while articles 1576-1578 C.C. deal with warranties and recourses.

102. See *Simard* v. *McColl Frontenac Oil*, (1959) B.R. 829; for the same result *vis-à-vis* a third party who has seized, see *Banque Fédérale de Développement* v. *C.F.M.G. Inc.*, (1979) J.E., no 75-564 (C.S.M.).

registration (article 1571d(2) C.C.).[103] In other words, while the date of signification is crucial insofar as payments by the debtor are concerned (*i.e.* does he pay the assignor or the assignee?) it is our view that article 1571d(2) C.C. sets the key date so far as competing assignees are concerned as the date of registration.[104]

To be contrasted with the sale of receivables is their pledge, which, in principle, is regulated by the rules of simple pledge requiring dispossession.[105] An exception to the requirement that the deed itself be remitted to the pledgee is, however, provided in the case of the pledge of present and future book accounts of a commercial business. Article 1966(3) permits a form of documentary pledge in which the execution of a deed of pledge in authentic form, or its delivery to the pledgee if it is by private writing, avails as a putting of the pledgee in possession. Hence, the pledgee may avail himself of article 1975 C.C. and retain the book accounts until he is paid, or of 1971 C.C. and stipulate a *pacte commissoire* giving him a right of ownership upon default. However, because article 1578 C.C. applies to the contract of pledge, in order to perfect his rights against non-debtor third parties he must register his deed under article 1571d C.C. and article 2127 C.C. if a priviledged or hypothecary claim is in issue.[106] Even when so perfected, in the absence of a *pacte commissoire,* which itself requires the additional formality of newspaper publication to be effective against account debtors, the rights of the pledge creditor are limited. He might exercise a right of retention, which prevents the subsequent assignment of the receivables but which does not permit him to collect these accounts. He might cause his deed of pledge to be seized and judicially sold, for whatever small price it might bring given that it is not perfected

103. See *Jankauskas* v. *Société Nationale de Fiducie.* (1963) R.L. 146 (C.S.) and COMTOIS, (1963) 65 *R. du N.* 447 for opposing positions on this point under the former article 1571d C.C. In *Comcap Factors* v. *Faucher,* (1979) J.E., no 79-680 (C.S.M.), now under appeal, the court gave support to the view that registration is the important element with respect to non-debtor third parties. *Contra* POURCELET, *op. cit.,* f.n. 51, 186; ROUSSEAU-HOULE, *op. cit.,* f.n. 6, 186 supports the position taken here and cites *Vigneron Construction* v. *Royal Bank,* (1976) C.S. 367.

104. In *Le groupe Traders Ltée* v. *Commercial Credit.* (1974) C.A. 247 the Court held that as between competing assignees the relevant date was the date of signification or acceptance (which under 1571d (2) is the date of registration).

105. See, however, *Bastien* v. *Dessurealt Inc.,* (1962) S.C.R. 97 and *Canadian Terrazo* v. *Kaplan,* (1960) C.S. 505 for attempted pledges which the courts found to be sales requiring signification for perfection.

106. See *In re Civano Construction: Gingras* v. *Crédit M.G.,* (1962) C.S. 45. For privileged claims see *Lemcovitz* v. *Laurentide Acceptance,* (1966) B.R. 160.

against the account debtors, and be preferred on the proceeds.[107] Consequently, one finds in practice almost no examples of a true pledge of receivables.[108] Rather creditors will often take an assignment of book debts, perfect it through registration and newspaper notice, yet permit the assignor to act as a mandatary for the purposes of collection.[109]

The assignment or pledge of receivables raises several issues as to the treatment of proceeds by the civil law. Specifically, may a secured creditor who permits the sale of an object over which his security lies, transform his security into a claim upon the proceeds of the sale? The concept of real subrogation is relatively undeveloped in Quebec law, although courts now permit a creditor to exercise his preference upon proceeds of a consensual sale after seizure,[110] and recent amendments to the Code permit privileged claims to be exercised on the proceeds of property insurance in the event of loss.[111] Nevertheless, upon the ordinary sale of an object, vendor's privileges and privileges of the trustee for bondholders (if the trust deed does not expressly extend to receivables) would be extinguished and could not be exercised upon the proceeds. Similarly, an unpaid conditional seller has no preferred claim on the proceeds of a subsequent sale or pledge of his property. By contrast as the

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107. Article 1577 C.C. subjects this preference to the rules of article 1983 ff. C.C. with respect to third parties. See *Sous-ministre du revenu* v. *Total Rental*, (1979) C.S. 840 (C.S.M.) for a confirmation of this interpretation of the pledgee's rank.

108. In our opinion sufficient attention has not been paid to the effects of a true pledge of receivables. PAYETTE, *loc. cit.*, f.n. 95, 302-311 suggests that in the absence of an express convention payment must be made to the pledgee who holds the money so paid as the pledge. While this may perfect the pledgee's right of retention it requires a prior publication under article 1571d C.C. In the absence of newspaper publication, the pledgor must be permitted to collect the *Quebec* v. *Desmarais*, (1976) C.A. 11 when, after the pledge was extinguished, the previous pledgor sued the account debtor it was necessary for the pledgor to implead the pledgee because notice of the pledge has been previously given to the account debtor. If no previous notice had been given the previous pledgor could simply sue the account debtor in his own name. In *Re Canadian Terrazo and Marble*, (1966) C.S. 505 the account creditor could not sue on the debt because the court found an assignment, not because as pledgor it would have had no status to do so in the absence of a newspaper notice. See also MARCOTTE, *loc. cit.*, f.n. 3, 74-75.

109. See *Stone Electric* v. *Community Development Ltd.*, (1972) C.S. 397 for explicit approval of such a procedure. If creditors take a perfected pledge, in our view they alone are entitled to payment, yet they must hold such payment as a pledge unless they have otherwise stipulated (article 1971 C.C.).

110. *Mechanic Supply* v. *Hudon*, (1933) 71 C.S. 400.

111. Article 2586 C.C. Or course, banks and those with title security would receive the indemnity as owners.

Lefaivre case held[112] the bank holding a section 88 security has a claim upon the proceeds by virtue of its proprietary interest. The commercial pledgee may simply assert his preference notwithstanding the sale of the pledged goods,[113] while the endorsee of a bill of lading himself has control of the merchandise and presumably would release it only upon payment to himself.

These considerations illustrate the scope of accounts receivable financing. They reveal why book accounts are invariably assigned rather than pledged, and indicate the temporal approach to priorities in such cases. Finally, they show how the absence of a doctrine of real subrogation prejudices all inventory financers other than banks.

2.7. Medium and Long-Term Financing — the Trustee for Bondholders

The right to secure a bond issue through a trust deed under the *Special Corporate Powers Act* creates an exceptional regime of commercial financing in Quebec which is particularly useful to lenders seeking security over raw materials and inventory.[114] Once again the legislation regulating the security is extremely laconic, being set out in sections 27-31 of the statute. Consequently, parties usually set out their respective rights in detailed trust indentures which include, *inter alia,* provisions respecting: additional issues, currency, charging provision "normal course of business" releases, redemption, restrictive covenants, amendments, default, remedies, application of moneys received by the trustee, other duties and powers of the trustee, and cancellation of the indenture.[115]

Section 27 of the Act permits incorporated companies, notwithstanding any other law (*e.g.* the Civil Code), to "hypothecate, mortgage or pledge any property, moveable or immoveable, present or future, which it may own in the province", "for the purpose of

112. *B.C.N.* v. *Lefaivre,* (1951) B.R. 83; see also *Re Western Canadian Millwork Ltd.: Flintoft* v. *Royal Bank,* (1964) S.C.R. 631.

113. *In re Bertrand,* (1967) C.S. 596.

114. See generally, McNAMEE, "Security under the Special Corporate Powers Act", (1967) *Meridith Memorial Lectures* 34; (1976) *Meredith Memorial Lectures, passim;* SMITH and RENAUD, *op. cit.,* f.n. 3, 935-1026; RENAUD, "L'efficacité de l'acte de fiducie comme sûreté", (1979) *C.P. du N.* 199.

115. See McNAMEE, *loc. cit.,* f.n. 114, 38-39; TETRAULT, "Pitfalls under Trust Deeds", (1976) *Meridith Memorial Lectures* 17; see also RAINVILLE, "Aliénation par fidéicommissaire", (1979) *C.P. du N.* 257.

securing any bonds, debentures or debenture stock which it is by law entitled to issue." Section 28 stipulates that such security must be constituted by a trust deed to any trustee, and is valid notwithstanding that the debtor remains in possession of the property over which the security lies. Section 30(1) confirms the right of the company to cede and transfer its property to the trustee as security for its bonds and provides that the trustee has the power, in the event of default, to take possession, administer, and sell the property so ceded and transferred. Sections 29(2)-(4) provide for registration of the deed and for the priority of the trustee's claim. For our purposes, the financing of moveables, the security has effect only from the date of the registration of the deed by deposit in the registry office of the division where the company has its head office as well as every other division where it has a place of business.[116] The privilege conferred under a trust deed ranks after all those enumerated in articles 1994-1994c C.C.[117] Section 31 of the statute provides for an exceptional method of assigning book debts to the trustee which derogates from article 1571 C.C. Hence, it can be seen that although the act differs from the ordinary civil law, it must otherwise be integrated therewith (section 29(1) and rests on several traditional distinctions: moveable/immoveable; corporeal/incorporeal; fungible/non-fungible (which in the act is transmuted into the concepts of floating and fixed charges).

While this form of security device greatly increases the ability of a corporation to finance moveables, it also raises problems with respect to the attachment of security. Of course, there is little difficulty with land (including equipment which has become immobilized by destination) listed specifically in the deed or acquired subsequently. Articles 2042 and 2120a C.C. provide for perfection of such hypothecs under trust deeds. However, moveables create some difficulty because they may be subject to either a fixed or floating charge.[118] Nevertheless, since the deed confers a

116. See *Re Alliance Credit Corp.*, (1973) 17 C.B.R. (n.s.) 136.

117. The omission of the privilege set out in article 1994d C.C. is probably an oversight resulting from the fact that the *Special Corporate Powers Act* was originally enacted by (1914) 4 Geo. V. c. 51 while article 1994d C.C. was added by (1914) 4 Geo. V. c. 64. Crown privileges under special statutes have been assimilated to this list by 2006a C.C. See *Sous-ministre du revenu* v. *Total Rental*, (1979) C.S. 840 and PAYETTE, "La charge flottante", (1976) *Meredith Memorial Lectures* 52, 59 who suggests all superior ranking privileges (*eg.* the endorsee of a bill of lading) are included by section 29 (2). We find that this solution goes beyond the clear language of the act and should be rejected. *Cf.* PAYETTE, (1980) 40 *R. du B.* 337.

118. McNAMEE, *loc. cit.*, f.n. 114, 39.

privilege which has a rank determined by the Code and not by the date of perfection, the effects of this distinction are limited.[119] A floating charge is invariably taken over materials, inventory and receivables, and since it floats it raises several questions as to alienation, after acquired property, priority and recourses.[120] If the trust deed permits alienation of property subject to the charge, this may occur without formality. However, in the absence of such a clause, we conclude that by virtue of article 2268 C.C. an acquirer may extinguish the trustee's rights if the goods are bought in good faith, and that because the deed is registered, "good faith" can only be present when the buyer is dealing with a trader dealing in similar articles, and not in commercial matters generally.[121]

Habitually trust deeds contain after acquired property clauses extending to receivables. Section 31 of the act expressly deals with such clauses by providing that upon default, but only upon default, can the trustee perfect either against account debtors or other third parties by newspaper publication or actual service under 1571 C.C.[122] Hence, until default the company may validly pledge, sell or compensate its accounts free of the trustee's claim,[123] and even upon default an automatic cession clause will not avail in the absence of newspaper notice.[124] It follows from the above that the trustee normally acquires a very low priority by virtue of the trust deed: his privilege on corporeals ranks last;[125] and his effective possession of incorporeals may date only from default by the debtor. As a result, trust deeds often contain special covenants according additional rights to trustees. First, a clause prohibiting the creation of additional higher ranking security is usual. These have been held, notwithstanding registration, not to be opposable to third parties[126] and only useful as stipulating a condition of default.[127] Second, the

119. Usually there is an express clause prohibiting alienation of assets subject to the fixed charge without the trustee's permission and stipulating unauthorized alienation as a default condition.

120. See PAYETTE, "La charge flottante", (1976) *Meredith Memorial Lectures* 43.

121. *Accord*, PAYETTE, *loc. cit.*, f.n. 120, 64-69. He rejects theories based on articles 2022 and 1027 C.C.

122. See *B.C.N.* v. *Normandeau*, (1976) C.S. 285.

123. For example, *In re Quebec Trucks and Trailers*, (1968) C.S. 418.

124. *Jankauskas* v. *Société Nationale de Fiducie*, (1963) R.L. 146.

125. Subject to the possible application of article 2094 C.C. to an unregistered commercial pledge.

126. *Trust général du Canada* v. *Chalifoux*, (1962) S.C.R. 456.

127. *Simard* v. *P.G. du Canada*, (1980) J.E., no 80-506 (C.S. Roberval).

deed may give the trustee power upon default to take possession and administer the secured property[127a] even as against the company's liquidator, and to exercise a right of retention under 1975 C.C.[128] against other creditors and a trustee in bankruptcy[129] although apparently not to revendicate possession from a trustee in bankruptcy.[130] Finally, in order to improve his rank, the trustee will also often take an ordinary commercial pledge over all machinery and equipment as well as an ordinary assignment of receivables perfected under 1571d C.C.

This review demonstrates the versatility of this security device and also its limitations. Only an incorporated business may employ it; even with a fixed charge it affords only a very low ranking privilege; it is defective as to perfection of accounts receivable financing; it often requires multiple registration — under section 29, and article 2042, 2120a, and 2127 C.C.; research is difficult since the registry index is chronological within each letter of the alphabet for debtors' names; finally, it gives no protection against the creation of subsequent higher ranking security devices.

2.8. A Special Regime of Financing — Security Under the Bank Act

The security avaible to banks under the *Bank Act* may be by way of documentary pledge under section 86 and 87, which has already been discussed, or by way of a special security under section 88 of the Act.[131] This constitutes the most important exception to the prohibition against security over moveables in the possession of the debtor in Quebec law. The specific qualities of the parties who may grant security and the objects over which security may be taken are set out in sections 88(1) (a)-(h), whose provisions must be strictly interpreted.[132] For our purposes it is section 88(1) (b) relating to

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127a. See LAPOINTE, "Prise de possession et avis de soixante jours...", (1979) *C.P. du N.* 219.

128. *Quaere* whether 1975 C.C. may be invoked with respect to an immoveable antichrèse.

129. *Hébert* v. *Trust général du Canada*, C.A.M., no 09-000 498-72, 1974.

130. *Re Les Pharmacies Modernes*, (1975) 19 C.B.R. (n.s.) 161.

131. See generally, LeDAIN, *loc. cit.*, f.n. 3, 103-111; TAVISS, "Section 88 of the Bank Act Inventory Financing", (1967) *Meredith Memorial Lectures* 44; SMITH and RENAUD, *op. cit.*, f.n. 3. 1046-1083; MARCOTTE, *loc. cit.*, f.n. 3. 79-82; FALCONBRIDGE, *Banking & Bills of Exchange*, 6th ed., 1956. pp. 216-258.

132. See *Gagnon* v. *Provincial Bank*, (1979) C.A. 178. In this case a wholesaler of air conditioners was held not to be a manufacturer for the purposes of 88(1)(b) nor a wholesaler of any permitted category of goods under 88 (1) (a).

manufacturing which is most relevant. Security may be given by the manufacturer over his goods, wares and merchandise manufactured or procured for manufacture, or procured or used in the packing of goods so produced. Hence, raw materials and inventory, but except for packing equipment, not machines may be subject to the bank's guarantee.[133] Section 89(6) and (7) regulate who may grant security and provide that if security is given under 88(1) (f)-(i) the bank may assign its rights, or if a third party guarantees a loan to the bank and satisfies the debt, the guarantor is subrogated to the bank's rights. Habitually, other lenders will arrange to have a bank advance money upon a section 88 security to their clients whose indebtedness to the bank they then guarantee. Upon default the lender pays the bank and is subrogated to the bank's rights. Section 90 requires a concomitance of the loan and the security, or a written promise by the borrower to grant security.

The most important aspects of the bank's security relate to the informality of its creation, the juridical nature of the security itself and its effect *vis-à-vis* other creditors. As to creation, section 88(4) merely requires the bank to register at the local office of the Bank of Canada, within three years prior to the granting of security, a notice of its intention to do so which must follow a form set out in the Act. That form neither specifies the amount of the loan, nor the objects over which security is taken.[134] Once this notice is filed the security is perfected (subject to the acquisition of the property covered) by the completion of a document granting the security to the bank (section 88(2)). The exact nature of the bank's guarantee has been a matter of some controversy. Section 88(2) (c) states that the bank has the same rights as if it had taken a warehouse receipt in which the property was described. This provision has been interpreted as giving the bank a *sui generis* right of ownership in the goods.[135] As a consequence, it may invoke real subrogation to replacement goods[136] and may, under section 89(5), assert its right over goods manufactured from materials over which it had security.[137] Again,

133. By virtue of section 88 (2) the borrower must be the "owner" of the property affected or become the "owner" thereof before release by the bank.

134. For security under section 88 (1) (g), if immoveables are affected a second registration in the local land registry office is required (section 89 (2)).

135. *Landry Pulpwood Ltd.* v. *B.C.N.*, (1927) S.C.R. 605; *Re Western Canadian Millwork Ltd.: Flintoft* v. *Royal Bank*, (1964) S.C.R. 631.

136. *Re DeVries and Royal Bank*, (1975) 8 O.R. (2d) 347 (H.C.) aff'd 11 O.R. (2d) 583 (C.A.).

137. *Royal Bank* v. *Port-Royal Pulp and Paper*. (1939) S.C.R. 186; *Lord* v. *Canadian Last Block Co. Ltd. and Royal Bank*. (1917) 51 C.S. 499.

this characterization has been held, in the *Lefaivre* case, to give the bank security in the proceeds from the sale of secured property, including accounts receivable, without the necessity of a formal assignment of book debts.[138] Finally, it follows that the bank may take possession of and manage the property over which it has security[139] and proceed to sell the property under section 89(4) in order to realize upon its security.[140]

Such a characterization leads to several difficulties as to the relationship of the bank's security to other creditors. Under section 89(1) the bank has priority over rights subsequently acquired in the property, including those of persons holding non-consensual privileges,[141] commercial pledgees, trustees under trust indentures, or assignees of accounts receivable, and unpaid vendors whose privilege arises without knowledge by the bank. However, even should the bank have knowledge of the vendor's rights (which is likely only if the vendor remains in possession) once the goods are delivered the vendor is no longer within the conditions required by article 1543 C.C.,[142] although arguably he might avail himself of his rights under articles 1998-2000 C.C.[143] Vendors whose rights arise

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138. *B.C.N.* v. *Lefaivre,* (1951) B.R. 83.

139. Section 88 (3) refers only to security under section 88 (1) (c) — (i). Such a right for security under section 88 (1) (a) or (b) must be contractual, which raises difficulty as to how to characterize this right. See *Provincial Bank* v. *Jacques.* (1955) R.L. 197 where it was seen as a *pacte commissoire.* In our view this right should be seen simply as an additional guarantee since the bank ultimately may not keep the goods seized. See *Provincial Bank* v. *Martel,* (1959) B.R. 278 for a correct characterization.

140. If agreed, the bank may proceed to a sale otherwise than by the formalities of 89 (4) and such sale vests the purchaser with the same title as was held by the individual granting the section 88 security.

141. We will not discuss here section 88 (4) dealing with workmen's wages, nor the privilege of the lessor, which was raised earlier. In *Re Fermo's Creations,* (1970) 10 D.L.R. (3d) 560 (C.A. Que.) the court founded the bank's priority on section 89 (1) which, by paramountcy rules, overrides article 1639 C.C. This solution should be contrasted with cases cited in footnote 87 *supra. Cf. In re Alfandri Inc.,* (1957) C.S. 448 for the position upon bankruptcy. Insofar as the repairman's right of retention is concerned, see *Bank of Montreal* v. *Guaranty Silk Dyeing and Finishing,* (1934) 15 C.B.R. 104 (C.A. Ont.) where the bank was subordinated to the repairman on the grounds that it had implicitly consented to the work being undertaken.

142. *Bock et Tétrault* v. *Fonderie de l'Islet et B.C.N.,* (1971) C.S. 379.

143. In *Re Eastern Wood Co.,* (1975) C.S. 539 the court held that the terms "into the hands of a third party who has paid for it" envisioned a section 88 security of the bank. This confirms the view that the bank has a right of ownership *sui generis.* But see, *supra,* f.n. 65.

prior to those of the bank are not outranked according to section 89(1) but given the above interpretation of the bank's interest, any preferred rights (other than a right of retention under articles 1496 and 1497 C.C.) would be extinguished. Hence, the only category of seller with priority over the bank is the conditional seller who retains title (section 88(2)).

Commercial pledgees who acquire rights prior to the bank will rank ahead of the bank by virtue of the same section. A difficult issue of priority arises with respect to trustees under a trust deed. By virtue of section 89(1) and section 25 of the *Special Corporate Powers Act* the bank outranks subsequent trustees.[144] It is our view that the bank may outrank even a prior trustee, notwithstanding section 89(1), because of the very nature of the trustee's guarantee.[145] With respect to accounts receivable financers the situation is more complex. If the bank's rights extend to proceeds there is no question that a subsequent assignee will acquire no superior rights to those of the bank unless the bank consents.[146] A pre-existing assignee faces the problem that his security attaches to the proceeds only upon sale of the goods covered by the bank's guarantee, which is also when the bank's claim arises. Section 89(1) does not deal with this question, and our view is that because the bank is exercising rights as owner, the debtor generates no accounts receivable, and hence the pre-existing assignee may have no claim on these accounts.[147] Consequently, we suggest that the bank will be able to trace to proceeds, and also will have priority over pre-existing receivables financers as to book debts. A final point as to the rights of the bank

144. *Lord* v. *The Canadian Last Block Co. Ltd. and Royal Bank*, (1917) 51 C.S. 499.

145. *Contra*, HANNAN, "Trust Deed Security and Competing Creditors", (1976) *Meredith Memorial Lectures* 29, 40. It is clear that any subsequent privilege outranks the claim of the trustee, notwithstanding an express clause prohibiting the creation of such security. *Trust General* v. *Chalifoux*, (1962) S.C.R. 456. Moreover, if the Bank takes ownership this should extinguish the trustee's claim over such goods, since the trust deed gives no right to follow. For a recent discussion see *Provincial Bank* v. *Canada Trust*, (1979) C.S. 234. SMITH and RENAUD, *op. cit.*, f.n. 3, share this view (pp. 1080-1081).

146. In *Canadian Imperial Bank of Commerce* v. *General Factors*, (1968) S.C.R. 435 the court held that when accounts were discounted to a factor and payment was made jointly to and accepted by the debtor and the bank, the assignee factor had preference for the collection of accounts so discounted.

147. But see *Re Western Canadian Millwork Ltd.: Flintoft* v. *Royal Bank*, (1964) S.C.R. 631, 635 where the court suggests that subsequent innocent third party purchasers of accounts without notice outrank the Bank. However this result is a consequence of the different attitude taken by the common law to the nature of the bank's *debtor's* interest in the accounts receivable generated by the sale of inventory.

relates to subsequent third party purchasers of the section 88 collateral. If the bank consents to sale by the debtor[148] or if the purchaser may invoke articles 1488-1490 and 2258 C.C., [149] the bank will not be able to invoke its rights as owner against such third parties.

2.9. Conclusion

This brief summary of the law respecting the financing of moveables has highlighted several features of the present legal framework in Quebec. Of course, limitations imposed by the hypothetical problem we have selected and by space available have prevented us from offering more than a synoptic coverage. The analysis undertaken supports the conclusion that the current law is in need of reform, notwithstanding that the legal community has, by and large, been able to overcome its deficiencies through creative use of trust deed security under the *Special Corporate Powers Act* and accounts receivable financing. Nevertheless, at least two major improvements would seem to be indicated: first, insofar as possible, security on moveable property should be recognized as a separate right from that of title, and any form of security should be placed on the same juridical footing; secondly, creditors' remedies should be standardized and regulated by law. To achieve successfully these improvements, however, two pre-conditions must be met: first an adequate registry system must be instituted, and second, the bench and bar must be sympathetic to the proposal. The experience of common law provinces is particularly relevant in respect both of these suggested improvements and these pre-conditions.

3. The Position in Ontario

3.1. Introduction — the Personal Property Security Act

When the problem is translated into an Ontario context, one discovers a different set of problems from those presented in Quebec. There are some points of overlap, however.

The major difference is represented by the application to our problem of Ontario's *Personal Property Security Act (PPSA.)*[150] The

148. *Hurly* v. *Bank of Nova Scotia*, (1966) S.C.R. 83.

149. *A.-G. Canada* v. *Mandigo*, (1965) B.R. 259; *Bank of Montreal* v. *Repaco Inc.*, (1979) C.P. 199. But see *Re Fermo's Creations*, (1970) 10 D.L.R. (3d) 560 (Que. C.A.).

150. *Personal Property Security Act (PPSA)*, R.S.O. 1970, c. 344, as amended by S.O. 1972, c. 1, s. 52; S.O. 1973, c. 102; S.O. 1976, c. 39 and S.O. 1977, c. 23 (in force 1

highlights of this remarkable foray into commercial law reform are well documented elsewhere, and only a brief summary is necessary here.[151] The *PPSA* draws its inspiration from the secured transactions part (Article 9) of what is perhaps America's most successful piece of law reform, the *Uniform Commercial Code (UCC)*.[152] The Ontario *Act* is stated to apply to every consensual transaction that in substance creates a "security interest" (section 2(a)).[153] A

April, 1976). An up-to-date copy of the Act and the Regulations and Forms thereunder is to be found in R.H. McLAREN, *Secured Transactions in Personal Property in Canada*, 2 vols, 1979, in vol. 2 pp. ONTARIO-1 to ONTARIO-61. The Ontario Act has inspired imitation which, however, is far from slavish: McLAREN, vol. 1, p. 1-2. Two other provinces have enacted legislation of the Ontario type. See the *Personal Property Security Act*, S.Man., c. 5, as amended by S.Man. 1977, c. 28; S.Man., c. 61, s. 10; S.Man. 1978, c. 21 and S.Man. 1979, c. 32 (in force 1 September 1978) in McLAREN, vol. 2, together with the Regulations and Forms under it, at pp. MANITOBA-1 to MANITOBA-95. See also *The Personal Property Security Act*, Bill 42 of 1979-80 (Sask.) (assented to on June 17, 1980 and due to come into force on April 1, 1981), not yet in McLAREN. The focus of this part of the article will be on Ontario's legislation; but where appropriate, reference will be made to the other legislation. Also, since this article was written, the Ontario Ministry of Consumer and Commercial Relations has published for purposes of comment *The Personal Property Security Amendment Act*, Bill — of 1980 (September, 1980). Account is taken in our footnotes of the changes it proposes of greatest significance to this study.

151. For a compact account putting the Act in historical context, see ZIEGEL, "Canadian Chattel Security Law: Past Experience and Current Development", c. 5, in J.G. SAUVEPLANE (ed)., *Security over Corporeal Moveables*, 1974. There are two treatises on the Act, which both have some shortcomings for present purposes. One treatise is F.M. CATZMAN et al., *Personal Property Security Law in Ontario*, 1976 (comparatively brief section-by-section commentary); the other treatise is McLAREN, *op. cit.*, f.n. 150 (more detailed treatment, for the most part, of what it covers; but coverage of e.g. some of the types of priority problems discussed here is still in course of preparation). There is also a growing body of periodical and judicial treatment. Where appropriate, account is taken of it.

152. The literature on the UCC, and Article 9 in particular, is immense by any standards, but must be read with caution because of Canadian divergeances from the parent. For an excellent introduction to the history of the UCC as a whole and an overview of Article 9, see J.J. WHITE & R.S. SUMMERS, *Uniform Commercial Code*, 2nd ed., 1980, Introduction and Chapters 22-26, respectively. There have been several editions of the UCC, comprising Official Text with extremely useful section-by-section Official Comments, but only two, those of 1962 [hereinafter cited as sec. 9 — (whatever the number involved) (1962)], have enjoyed widespread adoption among the U.S. states. Even then there are local divergeances which make cross-country generalization difficult: for a guide to the state divergeances, see 3 *Uniform Commercial Code (U.L.A.)* (1968-), which also can be used to gain access to the 1962 and 1972 Official Text and Comments.

153. The *PPSA* also applies to the absolute assignment of "book debts": see s. 2 (b), the reason for which appears in McLAREN, *op. cit.*, f.n. 150, vol. 1, p. 1-5, and is returned to in the text later.

"security interest" is simply an interest in "goods" (defined in section 1 (k)) — including "fixtures", the common law term for goods so affixed to land as to become in law part of the realty, without distinction as to the difficulty of their removal or the permanence of the affixation, or their utility value to the land (see also section 36).[154] A "security interest" can also be an interest in any one or more of a wide array of other personal property, including "intangibles".[155] In both cases the relevant interest is simply one "that secures payment or performance of an obligation" (section 1 (y)).

The breadth of the *PPSA's* coverage is indicated by its enumeration (in section 2 (a)) of examples of transactions it picks up. Some are more or less familiar common law security devices: chattel mortgages; floating charges; and pledges.[156] Others are transactions which because of the common law concern with title have been treated in law quite differently from secured transactions, notably the chattel mortgage — to which they are functionally very similar.[157] Of interest here is the *PPSA's* enumeration of conditional sales, and of leases "intended as a security". The point is driven home by the *PPSA's* statement (again in section 2 (a)) that it applies "without regard to the person who has title to the collateral".

The details of the scheme which the *PPSA* applies to the transactions described can be briefly mentioned here. Uniform rules for the creation of a security interest are established. The *PPSA* distinguishes between enforceability between the parties and as against third parties. As between the parties, an agreement which creates or provides for a security interest, called in the *Act* (in S.1(x)) a "security agreement", together with 'attachment' of the security interest are all that is required (section 11). 'Attachment' occurs (as described in section 12) when three conditions are fulfilled: the parties intend attachment; value is given; and the debtor has rights in the collateral. For enforceability of the security interest against

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154. The closet the common law comes to recognizing someting like the civilian immobilization by nature doctrine is the notion that certain goods may completely lose their identity in the land — e.g. seed that has been planted — when it would seem that the *PPSA* would cut out. See generally: F.H. LAWSON, *Introduction to the Law of Property*, 1958, pp. 21-22; and see also *infra* text accompanying and references in f.n. 201.

155. The *PPSA* provisions defining what personal property is covered here are s. 1 (i), (1), (w), (c) and (m).

156. The nature of these is where relevant explored later in the text.

157. See ZIEGEL, "Chattel Security", *op. cit.*, f.n. 151, 84.

third parties one further element is necessary: either the debtor is in possession of the collateral or a security agreement is drawn up and signed by the debtor which meets certain minimal requirements (set out in section 10). One important thrust of the new *Act* is thus readily to facilitate the creation of non possessory security interests in personalty.

Although a security interest has been created, and may be enforceable against third parties, that security interest is still liable to be subordinated to certain enumerated interests — notably the trustee in bankruptcy and execution creditors (see section 22). To attain protection against those interests, as well as to attain the best priority position *vis-à-vis* competing security interests in the collateral which the *PPSA* allows, a further step to those outlined is necessary. This step is called in the Act (see section 21) "perfection". Perfection occurs when (as section 21 stipulates) the security interest has attached, and all the steps required for perfection under any provision of the *Act* have been completed. There are two major alternative steps provided for. One is the secured party taking possession of the collateral (see section 24). The other, by far the more important, is registration (see section 25). Registration is accomplished by the filing of a "financing statement" in the form prescribed by the regulations to the *Act* (see section 47). This document is a relatively skeletal one, the highlights of which are the debtor's name (by which the statement is indexed), the name of the secured party and the type of collateral involved, a check mark or marks indicating whether it is one or more of "consumer goods," "inventory," "equipment," "book debts" or "other".[158] (Special provisions, for description of motor vehicle collateral, need not detain us here.) In striking contrast to predecessor legislation in Ontario, which will be returned to, there is no provision in the *PPSA* for filing the transactional document itself (the *Act's* security agreement).[159] The filing is simply a notice which will alert the searcher to the need to make further inquiries. The similarity to the *Bank Act,* section 88 security is marked; but there are some important differences. The *PPSA* filing cannot be made before the security agreement is executed, except in the case of "goods to be

158. The relevant Regulation section is O.Reg. 879/75 as amended by 547/79, s. 3; and see Form 1. See generally the very helpful publication of the Ministry of Consumer and Commercial Relations, *Registration Guide for the Personal Property Security System* reproduced in McLAREN, *op. cit.*, f.n. 150, vol. 2, pp, ONTARIO-62 to ONTARIO-116.

159. See McLAREN, *op. cit.*, f.n. 150, vol. 1, pp. 20-21.

held for sale or lease" (see section 47(2)).[159a] Nor may a *PPSA* filing be made more than 30 days from the date of such execution (see section 47(3)), subject to a judicial power to extend the time limit (described in section 63).[159b] There is a provision in the *PPSA* with no counterpart in the *Bank Act* providing limited rights of access (see section 20) to the security agreement. And the major priority rule in the *PPSA* ranks security interests all of which have been perfected by filing by order of registration, not by (the possibly quite different) order of perfection (see section 35(1) (a)). Only in the event that they are not all perfected by registration is order of perfection the priority rule (section 35 (1) (b)). In the event that none is perfected, the priority rule is order of attachment (section 35(1) (c)).

When one adds to the relatively simple registration requirements under the *PPSA* the fact that no affidavits of *bona fides*[160] are provided for, one has a better appreciation of a statute hospitable not only to the creation but also to the protection of non-possessory security interests. The measure of that hospitality is increased by provisions favourable to fluctuating credit and fluctuating collateral elements. The *PPSA* expressly recognizes (in section 15) that a security agreement may secure future advances, "whether or not the advances or other value are given pursuant to commitment". The *Act* also says (in section 13(1)) that a security agreement may cover after-acquired property, with an exception that is immaterial here. And the *Act* says (in section 27(1)) that "subject to this Act"[161] a security interest in collateral that is dealt with so as to give rise to proceeds "extends to the proceeds"; in addition, it would seem that if the security interest in the original collateral was perfected by a filing which covered proceeds, the security interest in the proceeds is perfected (see section 27(2) (a)).[162]

159a. However, this difference may soon largely be eliminated: see *The Property Security Amendment Act*, Bill — of 1980 (September 1980), cl. 16.

159b. Again, this difference may soon largely be eliminated: see *id.*, cll 16 and 24; but see also cl. 22.

160. The necessity for which under former law caused many secured parties much grief: McLAREN, *op. cit.*, f.n. 150, vol. 1, pp. 20-1 and 20-1 n.2.

161. A saving of concern here, and explored later in the text.

162. Although the point is not beyond argument: see the discussion in CATZMAN et al., *op. cit.*, f.n. 151, 132-33, 134; McLAREN, *op. cit.*, f.n. 150, vol. 1, pp. 4-2 to 4-3. And see *Re Kryzanowski*, (1979) 24 O.R. (2d) 18 (S.C. in Bankruptcy). A further issue is whether, absent express provision (see s. 34), priority in the proceeds is measured with respect to filing, other perfection or attachment for the original collateral. The better view is that such priority is to be so measured: see McLAREN, *op. cit.*, f.n. 150, vol. 1, pp. 6-6 to 6-7.

In addition to regulating the creation and the mechanics for obtaining protection of security interest, the *PPSA* elaborates in some detail — but not, as will be seen, exhaustively — the measure of that protection. It does this through a network of priority rules, the major one of which is a first to file or perfect rule (of section 35(1)). But a general security agreement could readily be structured under this *Act* which fully exploited its hospitality to flexible security devices, to the point of purporting by the first filing against that debtor to tie up under a first security all his present and after-acquired property, including proceeds. (The experience in Ontario is that banks are doing just that.) The *PPSA* seeks to avoid that result for after-acquired property whose acquisition is to be separately financed.[163] For that purpose the *Act* recognizes a special class of security interest of persons — sellers or lenders — who give credit which facilitates the acquisition, or who give value "that enables the debtor to acquire rights in or the use of the collateral, if such value is applied to acquire such rights" (section 1(s)). The holder of this "purchase money security interest" is, as we will see, capable of taking in priority to a secured party who filed before him, under certain limited conditions. For now we may note that regardless of whether "title" moved — which distinguished the pre-*PPSA* conditional sale from the (rare in Canada) vendor's chattel mortgage back (where title moved from vendor to purchaser and back to the vendor, as security) — the functional characteristics are emphasized over the formal.

Finally, to the unitary concept of the security interest we have seen the *PPSA* adds a uniform enforcement scheme. The scheme allows for three sources of rights and remedies for the secured party (see section 57). The first is any rights or remedies deriving from other statutes or rules of law — such as the appointment of a receiver.[164] The second source is the security agreement itself. The third source is the *PPSA*. From the third source the secured party receives a right to seize (see section 57) and dispose of the collateral free of all security interests (see section 58). To maximize the chances of obtaining the best price reasonably obtainable,[165] the disposition may be by "public sale, private sale, lease or otherwise". For the protection of the debtor, there are certain special notification rules (see section 58(5) and (6)); and the whole transaction must be

163. See McLAREN, *op. cit.*, f.n. 150, vol. 1, pp. 6-9 to 6-10.

164. See *Cantamar Holdings Ltd.* v. *Tru-View Aluminum Products*, (1979) 6 B.L.R. 209 (Ont. H.C.). See now *The Personal Property Security Amendment Act*, Bill — of 1980 (September 1980), cl. 20.

165. See CATZMAN et al., *op. cit.*, f.n. 151, 229.

"commercially reasonable" (section 58(3)). Finally, the *PPSA* gives the secured party in possession a right to retain the collateral in satisfaction of the secured obligation, subject to protections for the debtor and other secured parties (see section 60). Again, one sees a facilitative law which recognizes the value of secured financing on moveables while it seeks to afford reasonable protection for parties affected.

As the implications of this scheme for our problem are worked out, it will be seen that there are some difficulties with the Ontario scheme. Some are traceable to imperfect adaptation of the UCC's Article 9 scheme. Others are traceable to problems in Article 9 itself. But beyond both of those is a third set of problems, which represent the points of overlap with the Quebec discussion mentioned earlier. One group of these problems arise from the *PPSA*'s exclusion (in section 3(c)) from its provisions of a "mortgage, charge or assignment whose registration is provided for in *The Corporation Securities Registration Act*[166] [CSRA]". The other is from the federal *Bank Act's* provisions with respect to section 88 securities which the *PPSA* as provincial legislation cannot override, although to which it does not expressly defer.[167] A brief introductory comment on the *CSRA* issue is in order here. The *Bank Act* provisions have already been canvassed.

3.2. The Corporation Securities Registration Act

The *CSRA* provides for the registration of certain mortgages, charges and assignments, contained in certain documents, of certain collateral made by certain corporations (see section 2(1) read with section 1). The corporations affected are those "engaged in a trade or business in Ontario". The collateral involved must be one or both of book debts, (but not other choses in action), or tangible chattels, (but not ships or vessels or shares in them or fixtures or growing crops in certain circumstances or government or corporate securities). The mortgage can apparently be legal or equitable, the charge specific or floating and the assignment of book debts, whether by way of specific or floating charge. Such a security given over such assets by such a corporation is not caught, however,

166. *The Corporation Securities Registration Act (CSRA)*, R.S.O. 1970, c. 88, as amended by S.O. 1971 (2nd Sess.), c. 8: note especially s. 15. As will be noted, this exclusion may soon cease, and this Act be repealed.

167. See McLAREN, *op. cit.*, f.n. 150, vol. 1, pp. 6-21 to 6-22. But as will be seen there are no Bank Act provisions with respect to proceeds of dispositions of s. 88 collateral, which would appear to let in provincial law, although McLAREN, *op. cit.*, f.n. 150, vol. 1, p. 6-22 might be read to imply the contrary.

unless that security is contained in a trust deed or other instrument to secure "bonds, debentures or debenture stock of the corporation or of any other corporation"; or contained in any "bonds, debentures or debenture stock of the corporation" themselves, whether or not also contained in a separate instrument. The typical *CSRA* security is the fixed and floating charge contained in a trust deed to secure a public issue of corporate debentures. But the coverage is much wider. The question of the ambit of that coverage, so crucial for the *PPSA*'s application or lack of it, is made acute by the lack of any authoritative exposition of the meaning of "debenture" in the *CSRA*.[168] Precedents on the meaning of the word go as far as describing it as any written acknowledgement of a debt by a corporation.[169] Does this mean that any written security agreement by an Ontario corporation which creates a security interest over the listed types of collateral and whose security interest sufficiently resembles an item in the pre-*PPSA* taxonomy used in the *CSRA* is caught? If so, there may be little work for the *PPSA* to do for corporate security agreements, which would be surprising. So far as the legislative history of the *PPSA* goes, it suggests that the rationale of the *CSRA* exclusion was to protect long term corporate debt holders from the lapsing of the registration of *PPSA* security interests, which unless renewed are only effective for three years (see section 53).[170] Such debt holders can be conceived of as typically insulated from the debtor by a trustee, and as having individually insufficient sophistication and an insufficient stake adequately to supervise that trustee in this respect.[171] The scope of the *CSRA* exclusion is not well tuned to that concern, however.[172] One case authority appears to have gone to the extreme pointed to here.[173] A

168. See the discussion of the case-law referred to in the succeeding text in McLAREN, *op. cit.*, f.n. 150, vol. 1, pp. 1-7, n. 19. The term "bond" is no more clearly defined; and for the kind of instrument in question here, "debenture" could as likely be used to describe it: see W. GROVER & D. ROSS, *Materials on Corporate Finance*, 1975, pp. 234, 318.

169. See *Canada Permanent Mortgage Corporation* v. *The City of Toronto*, [1953] O.R. 966 per J.A. HOGG at p. 975 (C.A.). The dictum suggests that a fixed, not a floating amount of indebtedness may be necessary: see on that point McLAREN, *op. cit.*, f.n. 150, vol. 1, p. 1-7, n. 19.

170. See McLAREN, *op. cit.*, f.n. 150, vol. 1, p. 1-6.

171. See LAW REFORM COMMISSION OF SASKATCHEWAN, *Proposals for a Saskatchewan Personal Property Security Act*, 1977, p. 92.

172. Compare the approach taken under the Manitoba and Saskatchewan legislation, discussed later in the text.

173. See *Turf Care Products Ltd.* v. *Crawford's Mowers and Marine Ltd.*, (1978) 23 O.R. (2d) 292 (H.C.), motion for leave to appeal denied 23 O.R. (2d) 292n (Div. Ct.).

later decision of coordinate authority[174] announced, much to the relief of the commercial bar in Ontario,[175] that the 'true' rule depends on the intention of the parties as manifested in their agreement(s). Striking a discordant note with the 'substance over form' theme of the *PPSA* that later authority seems to suggest that it is the form of the parties' relationship not its substance which counts. Use of the *CSRA* precedents' "mortgages and charges as and by way of a first fixed and specific mortgage and charge" and "charges as and by way of a first floating charge"[176] will control over the *PPSA* precedents' "security interest" terminology.[177]

What is the operation of the *CSRA* on its creatures? It is cast in the mould of the sundry pre-*PPSA* personal property security statutes — *The Assignment of Book Debts Act,*[178] *The Bills of Sale and Chattel Mortgages Act*[179] and *The Conditional Sales Act.*[180] That is to say, the *CSRA*'s thrust is to make by section 2(1) its creatures "void" as against certain named classes of claimant in the collateral unless within a prescribed time a document setting forth the details of the transaction is registered in an office of public record. The named classes of claimant are "creditors of the mortgagor or assignor" and "subsequent purchasers or mortgagees from or under the mortgagor or assignor, in good faith, for valuable consideration and without notice" (see sections 2(1) and 1). Registration is accomplished by filing the prescribed transactional document together with the appropriate affidavits by an officer of the debtor corporation (see sections 2(2) and 3(1) and (2)). Filings are

174. *Re the Matter of the Bankruptcy of Turf World Irrigation Ltd.*, (1979) 7 B.L.R. 215 (Ont. S.C. in bankruptcy), distinguishing the authority in the previous footnote.

175. ZIEGEL, "The Quickening Pace of Jurisprudence under the Ontario Personal Property Security Act", (1979) 4 *Can. Bus. L.J.* 54, 59.

176. See the precedent in GROVER & ROSS, *op. cit.*, f.n. 168, 234, cl. 2.1 (a) and (b).

177. See the precedent in McLAREN, *op. cit.*, f.n. 150, vol. 1, pp. 31-3 to 31-7. For the apparent drafting difficulties to which the case-law thus far leads, see ZIEGEL, *loc. cit.*, f.n. 150, vol. 1, pp. 1-7, n. 19. The substance of the transaction may in certain cases have some relevance: see McLAREN, *op. cit.*, f.n. 150, vol. 1, p. 1-7, n. 19. And see *Re Hillstead Ltd.*, (1979) 9 B.L.R. 74, 81-82 (Ont. S.C. in bankruptcy).

178. *The Assignment of Book Debts Act*, R.S.O. 1970, c. 33, as amended by S.O. 1972, c. 1, s. 24 and S.O. 1975 (2nd Sess.), c. 4 and repealed April 1st, 1976.

179. *The Bills of Sale and Chattel Mortgages Act*, R.S.O. 1970, c. 45, as amended by S.O. 1972, c. 1, s. 27 and c. 22, and S.O. 1975 (2nd Sess.), c. 3 and repealed April 1st, 1976.

180. *The Conditional Sales Act*, R.S.O. 1970, c. 76, as amended by S.O. 1972, c. 1, s. 34 and c. 23 and S.O. 1975 (2nd Sess.), c. 5 and repealed April 1st, 1976.

indexed by the names of the parties to the transaction (see section 6). Filings are not subject to any renewal requirement.

What is the priority effect of *CSRA* registration apart from avoidance of the statutory subordination described? The statute itself does not say. There is no direct authority. One would expect that it would be more consistent with the scheme of the *ACT* to say it had some effect than it had none.[181] There is one obvious possibility for a common lawyer, used to the pre-*PPSA* personal property security priority rules. Those rules distinguished between legal and equitable interests. The general rule was that the first legal interest prevailed, unless a later legal interest took without value, or took for value but with notice of an earlier equitable interest[182] (as between equitable interests, the first in time prevailed).[183] What would be more compatible with the statutory framework than to say that registration was notice for the purpose of these rules? This would be of particular assistance for the common form of floating charge, which as will be seen is in the common law an equitable interest which permits the debtor to deal with collateral in the ordinary course of business unless the charge instrument otherwise stipulates. However, what relevant authority there is would suggest that no such view of the *CSRA* providing any such assistance is likely to be forthcoming from an Ontario Court.[184] Even more problematic is sorting out the priority position between the title-based pre-*PPSA*-*CSRA* interests and *PPSA* title-independent ones. There is no direct authority here either. As will appear the problem we have set requires a number of such sortings out.

Of course, one could avoid the *CSRA* problems by structuring the transaction which in Quebec would be arranged under the *Special Corporate Powers Act* as a *PPSA* security agreement, using exclusively *PPSA* terminology and relying on the most recent judicial authority referred to in this regard. The fixed interests on present and after-acquired equipment raise no difficulty. Nor on the face of it does a "floating charge": this as will be recalled is mentioned as one of the security interests to which the *PPSA* applies. Structuring the matching *PPSA* security interest will take some

181. *Cf. Kozak* v. *Ford Motor Credit Co. of Canada Ltd. et al.*, (1971) 18 D.L.R. (3d) 735, per HALL J.A. at p. 748 (Sask. C.A.).

182. See *e.g.* E. SYKES, *The Law of Securities*, 3rd ed., 1978, pp. 630, 320.

183. *Id.*, 630.

184. See the weight of the authorities discussed in ZIEGEL, "*G.M.A.C.* v. *Hubbard*: Statutory Conflict, Conditional Sales and Public Policy", (1979) 3 *Can. Bus. L.J.* 329, 331-32, 337-41, which, however, disagrees with the 'weighing of precedents' approach here.

skill because of the nature of the floating charge at common law. As previously mentioned, it is an equitable charge under which the chargee is free to deal with the collateral in the ordinary course of business,[185] subject here to the common prohibition on creating any prior or equal ranking "mortgage, lien or other encumbrance".[186] The charge's peculiarity is that it does not become enforceable against specific property within the class it comprehends until either the debtor goes into winding up or there is default and the creditor (or more typically his representative, the trustee) takes a step towards enforcement.[187] Although the drafting exercise is not an easy one, it seems that there is no substantial reason to doubt that a security interest with such characteristics is possible: one would have to have attachment, but to expressly subordinate the security interest to the other interests comprehended by the 'ordinary course of business' rubric, except (here) prior or equal-ranking consensual security interests.[188]

While one *could* avoid the *CSRA* problems in the way indicated, *CSRA* transactions continue to be structured following the old precedents and to be filed under the *CSRA*.[189] At least one reason is to provide a hedge against the current paucity of judicial authority. And so the appropriate discussion below will consider the position on each of the two alternatives here.

We will now examine the hypothetical problem in the same sequence of creditors as was followed in the previous Part of this paper: first, the position of the landlord is dealt with; then follow treatments of Friendly Finance, the suppliers to Widgets, Angrignon Acceptance, the trustee for debentureholders and the bank.

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185. See CATZMAN et al., *op. cit.*, f.n. 151, 63-64.

186. The quoted language is from the precedent in GROVER & ROSS, *op. cit.*, f.n. 168, 235, cl. 2.2; the effect of language like it is referred to in CATZMAN, *op. cit.*, f.n. 151, 64.

187. See ABEL, "Has Article 9 Scuttled the Floating Charge?", c. 27 in ZIEGEL & W.F. FOSTER (eds.), *Aspects of Comparative Commercial Law*, 1969, pp. 412-13. For a recent case discussion, see *Re Caroma Enterprises Ltd.*, (1979) 108 D.L.R. (3d) 412 (Alta. Q.B.).

188. See ABEL, *loc. cit.*, f.n. 187, *passim*. This is not to deny some residual problems: see ZIEGEL and CUMING, "The Renewal of Personal Property Security Law in Canada", pp. 24-33 (as yet unpublished paper, prepared for the 10th Annual Workshop on Commercial and Consumer Law, University of Toronto, October 17-18, 1980) and f.n. 279a.

189. In fact, for quite sound reasons it may be appropriate to register under both Acts: see R.E. FORBES, *Materials on Corporate Finance*, 1980 (mineographed, Osgoode Hall Law School, York University), p. 121.

3.3. The Landlord's Position

At common law in the province of Ontario the landlord has a right of "distress" on — that is, a right to seize and hold — goods on the rented premises for unpaid rent in arrear (but nothing more). The applicability of the right has however been cut back by statute, to non-residential tenancies. But the powers the common law conferred on the distrainor, limited to seizing and holding, have by statute been enlarged to include a power of sale. The common law inability to follow goods off the rented premises persists.[190]

No agreement is necessary to create the right of distress.[191] The *PPSA* appears expressly to exclude distress from the *Act*, as "a lien given by statute or rule of law" (see section 3(1) (a)), pursuant to an apparent policy to leave such non-consensual security devices to their own law.[192] How does the right of distress impinge on priorities?

Under *The Commercial Tenancies Act* of Ontario[193] the landlord's right at common law to seize goods of strangers[194] is restricted (in section 31 (2)). The right of distress is expressed not to apply to "the goods and chattels of any person except the tenant or

190. For a general discussion, see F.W. RHODES (ed.), *Williams' the Canadian Law of Landlord and Tenant*, 4th ed., 1973, c. 8. The statutory enlargement in Ontario is in *The Commercial Tenancies Act* (formerly *The Landlord and Tenant Act*), R.S.O. 1970, c. 236, as amended by S.O. 1972, c. 123; S.O. 1975 (2nd Sess.), c. 13; S.O. 1978, c. 18; S.O. 1979, c. 78, c. 135: see s. 53; the limitation is in *The Residential Tenancies Act*, S.O. 1979, c. 78, s. 31.

191. Strictly, it is simply "a particular remedy which arises on non-payment of rent": see WILLIAMS, *op. cit.*, f.n. 190, 243; and see next f.n.

192. There are exception to this stance referred to in s. 3 (1) (a). The landlord's distress is seen by us as included within s. 3 (1) (a), despite dicta in *Re Newmarket Lumber Co.: International Wood Products Ltd.* v. *Royal Bank*, [1951] O.R. 642, 645 (distress is not a "security": extensive case-law support), 646 (it is not a "lien"). Those dicta are better read as referring to the position before the right of distress is actually availed of; and even during that period it has a sufficient status to be a right "in, on or in respect of" the property subject to it (the basis of the holding in *Newmarket*). Once the right is availed of, the right becomes a "lien" within the *PPSA* provision: compare the view in the United States of the common law right of distress as it exists there, in (1970) 49 *Am. Jur. (2d), Landlord & Tenant* secs. 676, 726; and see also the authority which treats the landlord availing himself of that right as having an interest taken outside the scope of UCC Article 9 by sec. 9-104 (b) (1962 and 1972) ("landlord's lien") *e.g. Firestone Tire and Rubber Co.* v. *Dutton*, 205 A. (2d) 656 (Pa. 1964).

193. (Formerly *The Landlord and Tenant Act*) R.S.O. 1970, c. 236, as amended by S.O. 1972, c. 123; S.O. 1975 (2nd Sess.), c. 13; S.O. 1978, c. 18; S.O. 1979, c. 78, s. 135.

194. As to which see WILLIAMS, *op. cit.*, f.n. 190, 301 ff.

person who is liable for the rent". However, the scope of this restriction is limited by a further provision (also in section 31(2)) that the restriction does not apply "in favour of a person whose title is derived by purchase, gift, transfer, or assignment from the tenant, whether absolute or in trust, or by way of mortgage or otherwise, nor to the interest of the tenant in any goods or chattels on the premises under a contract for purchase or by which he may or is to become the owner thereof upon performance of any condition". Notice to the landlord is irrelevant to any of this.

This in effect conferred priority under pre-*PPSA* law on the landlord over chattel mortgagees and floating chargees.[195] With respect to goods the subject of a conditional sale, and absent a provision in *The Conditional Sales Act* (now repealed), the landlord could seize, but his right to the proceeds of sale was subject to the conditional seller's claim.[196] With respect to a bank's security under section 88 of the *Bank Act* it has been held in Ontario that a landlord's right to distrain in respect of arrears of rent arising before the security was taken is entitled to priority over the bank.[197] This was on the basis that the bank, as owner of the collateral by force of what are now sections 88(2) and 86 of the *Bank Act,* has "no special immunity, privilege or priority not possessed by other owners",[198] and that the right to distrain, while it was a right "in, on or in respect of" the collateral within the meaning of what is now section 89(1) arose when the rent became unpaid.[199] It would follow that once the bank's security was duly taken the landlord would be subordinated, by force of section 89(1), in respect of rent first becoming unpaid after that date.

One would expect that the landlord's claim is restricted to physical chattels, in view of the common law basis of it. Also, there is authority for the view that tender is not distrainable, unless in a sealed bag.[200] This would exclude accounts receivable, bank deposits and non-distrainable tender, but leave the manufactured widgets, the steel plate, the saw, the punch press and the boxing machine. However, the common law did not allow distraint in

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195. *Id.*, 306, 307.

196. *Id.*, 307-08.

197. *Re Newmarket Lumber Co.: International Wood Products Ltd.* v. *Royal Bank,* (1951) O.R. 642. *Cf. supra,* f.n. 11.

198. [1951] O.R. 642.

199. [1951] O.R. 645.

200. See WILLIAMS, *op. cit.,* f. n. 190, 297.

respect of "tenant's fixtures", which at common law in the absence of agreement to the contrary the tenant had a right to remove.[201] It is possible that the saw, boxing machine and punch press are tenant's fixtures here: it seems unlikely that they could be fixtures *simpliciter*.[202]

At this point then it can be said that the landlord will take priority over the *CSRA*-covered chargees. The landlord will also take priority over the bank in respect of section 88 collateral for rent unpaid at the time the bank took its section 88 security interest — which will be when Widget Inc. became "the owner" of the relevant collateral (the steel, finished widgets and the boxing machine — assuming that the latter is not a tenant's fixture). The determination of that date for the collateral subject to the conditional sale agreements is left until later. With respect to rent unpaid after that date the landlord is postponed to the bank in respect of that collateral. With respect to tender on hand representing proceeds of the May 1st sale, there is Supreme Court of Canada authority, that the bank as owner of section 88 collateral in the form of inventory becomes equitable owner of the proceeds of the sale which it has authorized.[203] Its priority position would fall to be determined under provincial law, however, as in our view section 89(1) is exhausted on the original collateral and, under section 89(5), the final product into which that collateral was manufactured.[204] In view of the Supreme Court of Canada authority cited, it is suggested that any distrainable tender would come under *The Commercial Tenancies Act* restriction of "goods and chattels of any person except the tenant". However, in view of the derivation of the bank's interest, through the original collateral, it is suggested that the bank is taken out of that restriction by the further words of the statute quoted above.

Much the most serious difficulties arise with respect to the *PPSA* interests here, which, as has been foreshadowed, may be taken to include creditors under a '*PPSA* style' debenture. Those difficulties arise because of *The Commercial Tenancies Act's* apparent distinction in the area of security agreements between "title" assignment and "title" acquisition ones, in terms of the

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201. *Id.*, 296.

202. See *id.*, 573-86.

203. *Re Canadian Western Millwork Ltd.: Flintoft* v. *Royal Bank*, [1964] S.C.R. 631.

204. Dicta in *id.*, 635, referring to subsequent purchasers without notice defeating the bank suggest this; see also the wording of s. 89 (2) and ZIEGEL, "The Legal Problems of Wholesale Financing of Durable Goods in Canada", (1963) 41 *Can. Bar Rev.* 54, 68-69.

classic common law distinction between the mortgage and the conditional sale.[205] The difficulty is of course that the PPSA does not distinguish between the two types of arrangement, including specifically the examples here; for its purposes the locus of "title" is irrelevant.

How then is *The Commercial Tenancies Act's* distinction to be drawn in a *PPSA* world? No safe answer is possible. To the extent the parties continue to use pre-PPSA precedents, as some still do, their choice will help; also, the parties might explicitly provide for title movement for the purposes of non-*PPSA* law.[206] Outside those two, there may be a difficult "guessing game" for the courts.

The difficulty does not arise because *The Commercial Tenancies Act* appears to want to distinguish between goods which were never, or were never intended to form, part of the tenant's patrimony, such as an automobile rented for a week-end, on the one hand, and goods which were or were intended to form such a part, on the other. Rather, the problem is that within the latter class the *Act* wishes to distinguish between types of (purchase money security) agreements which the *PPSA* recognizes as functionally identical. Perhaps the more limited scope of the common law privilege of distress compared with its civil law counterpart makes the former more palatable than the latter, a matter we will return to in our conclusion. But it seems to us that it is time the *PPSA* wisdom was brought to bear on *The Commercial Tenancies Act's* drafting.

3.4. The "Commercial Pledge" Security Interest: Security Over Equipment

The common law in modern times was never as hostile to non-possessory security interests as the Civil Code. Legislative intervention in Ontario in the form of what became *The Assignment of Book Debts Act, The Bills of Sale and Chattel Mortgages Act* and *The Conditional Sales Act,* all of which the *PPSA* superseded, can be

205. See SYKES, *op. cit.*, f.n. 182, 17: his chapters 1 and 24 in particular explore the difficulties in trying to preserve the two notwithstanding their functional similarity (viewed as financing devices). Note that *The Commercial Tenancies Act* does however allow for at least the hire purchase species of what in North America is called the "finance lease", which is discussed in its Canadian setting in VARCOE, "Finance Leasing — an Analysis of the Lessor's Rights upon Default by the Lessee", (1977) 1 *Can. Bus. L.J.* 117.

206. See *e.g. The Sale of Goods Act,* R.S.O. 1970, c. 421, s. 21 (risk follows "property"): here the goods would become the "property" of the tenant. And consider the agreement in *Rogerson Lumber Company Limited* v. *Four Seasons Chalet Limited,* (1979) 1 P.P.S.A.C. 29 (Ont. H.C.), aff'd 29 O.R. (2d) 193 (C.A.).

viewed in part as a reaction against the common law 'permissiveness'.[207] This is not to say that even the pristine common law was well adapted to modern commercial financing: as we will see, for example, in the area of priorities in proceeds, it was not. Viewed in this context the *PPSA* represents an attempt to provide the protections against secret liens of the statutes it replaced while at the same time integrating those protections with improvements in the receptivity of the legal system to changing commercial needs.

Under the PPSA a security agreement respecting the saw, punch press and boxing machine could readily be structured for Friendly Finance. The fact that these were or subsequently became 'part of the realty' under the common law as to fixtures would not affect it vis-à-vis other personal property security interests.[208] Both creation and perfection are relatively formality-free affairs although time limits for perfection by registration will need to be attended to; and if the goods are already fixtures, there must be "identification of the land concerned" (section 10(b)). The *PPSA's* disregard of title location means that no concern as to the ability of Widgets to create a security interest in the saw need be felt.[209]

Once perfection by registration has occurred, Friendly Finance will have priority over all subsequent filings to perfect consensual security interests in the saw, punch press and boxing machine. Friendly Finance must yield to previous filings. However, Better

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207. See ZIEGEL, *loc. cit.*, f.n. 151, 82, 86, 84 and 83.

208. However, it would be important vis-à-vis realty security interests: see *PPSA* ss. 36 and 54. The determination of when goods become "fixtures" is left to the common law, however: for a discussion of that common law, see the reference in f.n. 202, *supra*, which would indicate that the goods here if fixtures are probably "tenant's fixtures". If so, it would seem to us that until the tenant's right of removal is lost or waived, the realty interest whether arising before or after the goods became fixtures cannot take them as against the tenant or those to whom he grants chattel security interests: see *Sanders* v. *Davis*, (1885) 15 Q.B.D. 218; *Fish Meal Co.* v. *Nicherson et al.*, (1936) 2 D.L.R. 284 (N.S.); and KRIPKE, "Fixtures under the Uniform Commercial Code", (1964) 64 *Colum. L. Rev.* 44, 66. The point is explicit in UCC sec 9-312 (5) (1972).

209. However, Widgets must at least obtain "rights in the collateral" (*PPSA* s. 12 (1) (c)). The determination of that issue is left to the common law, to be influenced by the statute to the extent that is appropriate: see LAW REFORM COMMISSION OF BRITISH COLUMBIA, *Report on Debtor-Creditor Relationship — Part V Personal Property Security*, 1975, pp. 39-44. There is, however, no doubt that the common law in Canada saw conditional buyers as acquiring rights in the collateral even if there was some uncertainty as to how to characterize them: see ZIEGEL, *loc. cit.*, f.n. 151, 84; R.M. GOODE & J.S. ZIEGEL, *Hire Purchase and Conditional Sale*, 1965, p. 141.

Bank will succeed by virtue of *Bank Act,* section 89. And, as will be seen, if the debentureholders' mortgage of the equipment is filed as part of a *CSRA* trust deed under that *Act,* yet another non-*PPSA* priority rule is relevant. Priority over other third parties will, if they are not excluded from the *PPSA,* derive from the provision (section 9) respecting the effectiveness of attached security interests created under a security agreement satisfying minimal formal rules. There is an exception from this for ordinary course of business resales, which we will return to when we look at the position of the conditional sellers. The priority over conflicting consensual security interest holders should be reiterated: the fact that they may have been created earlier is if no moment if they were perfected later. (The purchase money security interest exception is inapplicable here.) That is why Steven's Saws would have raced to the register (with redoubled speed, as we will see, if it wanted the special purchase money security interest priority). The *PPSA's* thirty day rule is in that context not much of an inducement, a point repeatedly made about the *PPSA*[210] and picked up on in the other Canadian legislation which has followed it.[211]

So far as remedies are concerned, the important ones of seizure and sale are conferred on Friendly Finance by the *PPSA* itself, along with a form of foreclosure right, with any others coming from the security agreement itself and other law.

Could Friendly Finance use field warehousing in Ontario? Some forms at least of this are allowed for in the PPSA, which permits (see sections 28 and 24) security interests to be perfected without filing through the mechanism of a "document of title", which is defined in section 1(i). However, while that definition does not clearly exclude such documents, it would seem hazardous for a secured party to rely on a receipt issued by someone under the control of the debtor, except where the *Bank Act* makes reference to

210. See *e.g.* CATZMAN et al., *op. cit.,* f.n. 151, 184-85; ZIEGEL, "PPSA Registration Problems", (1979) 3 *Can. Bus. L.J.* 222, 227; LYSAGHT & SIMMONDS, "The Lapsed Registration Problem under the Ontario Personal Property Security Act", (1980) 4 *Can. Bus. L.J.* 442, 466. *The Personal Property Security Amendment Act,* Bill — of 1980 (September 1980) qualifies its removal of the thirty day rule (see cl. 16) by permitting persons who hold unsecured debt incurred between the expiration of thirty days after the execution of the security agreement and the secured party's registration of a financing statement to share in the latter's proceeds of disposition of the collateral (see cl. 22).

211. *The Personal Property Security Act,* S. Man. 1973, c. 5, as amended. s. 47(4); *The Personal Property Security Act,* Bill No. 42 of 1979-80, s. 44 (2) (Sask.)

the *PPSA* inappropriate.[212] This hazard arises from the lack of pre- or post-*PPSA* authority on field warehousing, coupled with the PPSA's perfection policy of informing outsiders of the need to inquire as to encumbrances.[213] In any event while field warehousing has been recognized in common law Canada as having the advantage of enhanced control of the collateral to set against its greater expense,[214] that expense and the ready availability of flexible non-possessory security devices for inventory would go far to account for its apparent lower incidence than that of those devices in Ontario.[215]

3.5. Purchase Money Security — the Claim of Vendors

At common law the unpaid seller who permitted title and possession to pass to the buyer without taking back a security interest (as could be done — but rarely in common law Canada — by a chattel mortgage back) had no remedy against the goods or their proceeds. He was left with only an unsecured claim for payment against the purchaser.[216] (The contrast with the Civil Code position is striking.) The *PPSA* does nothing about this. And neither does it appear that anything is proposed to be done about it,[217] either along the lines of a very limited (in time) revendication right like the one in the sales article (Article 2) of the American *Uniform Commercial Code,*[218] or in any other manner.

The seller who wanted to avoid this situation at common law most commonly resorted to the conditional sale, in which title was expressed not to pass until the buyer had paid the (credit sale) price.

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212. On the *Bank Act* in common law Canada, see *Re Monteith: Merchant's Bank* v. *Monteith,* (1885) 10 O.R 529 (C.A.) at p. 540 per C. BOYD; *In re Wedlock Ltd.,* (1926) 2 D.L.R. 263 (P.E.I.) (To same effect as in Quebec).

213. Consider on the *PPSA,* McLAREN, *op. cit.,* f.n. 150, vol. 1, p. 3-3. *The Warehouse Receipts Act,* R.S.O. 1970, c. 489 and *The Mercantile Law Amendment Act,* R.S.O. 1970, c. 272 (ss. 1 (c) and 8, 9) do not appear to have given rise to case law bearing on the point in issue here. On the hazards of field warehousing under the *UCC* see G. GILMORE, *Security Interests in Personal Property,* 2 vols, 1965, vol. i, pp. 441-445; and see *id.,* c. 6 (non-Code and pre-Code law). His discussion would suggest how the *PPSA* hazard should be neutralized: by filing.

214. See SULLIVAN, "Current Methods of Corporate Financing" in Canadian Tax Foundation, *Corporate Management Tax Conference,* 1974, pp. 5-6.

215. ZIEGEL, *loc. cit.,* f.n. 151, 80.

216. G.H.L. FRIDMAN, *Sale of Goods in Canada,* 2nd ed., 1979, p. 270.

217. See ONTARIO LAW REFORM COMMISSION, *Report on Sale of Goods,* 3 vols, 1979, vol. II, pp. 398-99, 414 and 429.

218. UCC sec. 2-702 (1962 and 1972).

Early legislative recognition of the functional similarity of the device to the chattel mortgage is provided by the conditional sales legislation of Ontario, first enacted in 1889, and finally repealed when the *PPSA* came into force. That legislation established the necessity for notice of the transaction through registration,[219] a state of affairs which the *PPSA* continues, albeit in a different form, and as part of an integrated statutory scheme. The *PPSA*'s coverage section, which has already been quoted, may be seen as a continuation, but at a much more functional level, of the common law attitude whereby attempts to use a network of sales to secure a refinancing were almost invariably treated as security arrangements.[220]

The conditional sale legislation referred to had from an early period a provision which facilitated the passage of unencumbered title from a conditional buyer to an "ordinary course of business" purchaser.[221] No similar provision was to be found in the chattel mortgage legislation and the other rules which could protect such persons were not wholly satisfactory.[222] The *PPSA* has a provision (section 30(1)) applicable to security interests (of any sort) given by a seller of "goods": a sale in the "ordinary course of business"[223] results in the "purchaser"[224] taking free of such a security interest "even though it is perfected and the purchaser actually knows of it".[225] There are somewhat similar provisions as to "chattel paper" and a "non-negotiable instrument".[226] However, those provisions are inapplicable to a sale of accounts receivable unless they are sold along with the seller's security interest in the goods, or they are in the form of a negotiable instrument. This is because of the

219. See ZIEGEL, *loc. cit.*, f.n. 151, 84.

220. See ZIEGEL, *loc. cit.*, f.n. 204, 61 n. 23.

221. An excellent discussion is in *id.*, 83-96.

222. See *id.*, 76-83, 96.

223. Not defined in the *PPSA*: compare *UCC* sec. 1-201 (9) (1962 and 1972) read with sec. 9-307 (1) (1962 and 1972).

224. Also not defined: it probably should be restricted to buyers (see CATZMAN et al., *op. cit.*, f.n. 151, 144), although this is hardly beyond argument (see McLAREN, *op. cit.*, f.n. 150, vol. 1, p. 10-10). compare *UCC* sec. 9-307 (1) (1962 and 1972) read with sec. 1-201 (9).

225. The rationale for a rule of this type is well brought out in WHITE & SUMMERS, *op. cit.*, f.n. 152, 1070. Buyers out of the ordinary course are protected against uperfected security interests, but only where they are "without knowledge of the security interest": *PPSA* s. 22 (1) (b) (i).

226. Similar, but not identical: see *PPSA* s. 30 (2) and (3) discussed in McLAREN, *op cit.*, f.n. 150, vol. 1, pp. 10-7 to 10-9.

difinitions of "chattel paper",[227] "instruments"[228] and "goods".[229] And the PPSA subordinates unperfected security interests to certain other kinds of sales.[230] Further, a secured party may expressly agree to subordinate himself,[231] or he may expressly or impliedly authorize the sale of the collateral, in which case his security interest will cease as to the collateral (although it will continue into the proceeds: see section 27(1)).[232]

So far as priorities absent express subordination are concerned, the common law followed through on its title reservation conception of conditional sales by limiting after-acquired property clauses in prior mortgages (and, it would follow, prior mortgage, charge or encumbrance limitations in floating charges) to the buyer's interest in the goods.[233] Further, as the conditional seller's interest was a legal one, he could not be displaced by subsequent interests.[234] However, when he had authorized a resale of the goods, limiting himself to a claim in the proceeds, his interest in them was liable to be defeated by a prior chattel mortgagee's after-acquired property clause. The better view in Ontario[235] seems to have been that unless the conditional seller had authorized the debor to resell as trustee or as agent (which he might be reluctant to do for other reasons),[236] the

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227. *PPSA*, s. 1 (c).

228. *Ibid.*

229. *Id.*, s. 1 (k).

230. See s. 22, part of which is referred to in f.n. 225.

231. See *PPSA*, ss. 39 and 51.

232. A result however which poor drafting of the *Act* makes it unnecessarily hard to reach: see references in f.n. 162.

233. See ZIEGEL, *loc. cit.*, f.n. 204, 74.

234. Absent the applicability of consent, waiver, estoppel, the "trader's section" in the conditional sales legislation or the protection afforded by the factors legislation: see *id.*, 76-96.

235. See *In re Fred's Farm Industries Ltd.*, (1957) 36 C.B.R. 125 (Ont. S.C. in bankruptcy), discussed in ZIEGEL, *loc. cit.*, f.n. 204, 104-05. But see *Ford Tractor & Equipment Sales of Canada Ltd.* v. *Trustee of Estate of Otto Grandman Implements Ltd.*, (1970) 72 W.W.R. 1 (Man. C.A.). And the position in England may be otherwise: see GOODE, "The Right to Trace and its Impact in Commercial Transactions — II", (1976) 92 *L.Q.Rev.* 528, 551-52, although see now *Border (U.K.) Ltd.* v. *Scottish Timber Products Ltd.*, [1979] 3 W.L.R. 672 (C.A.). The complete network of proceeds rules for the common law financing devices was said to "defy any rational explanation": ZIEGEL, *loc. cit.*, f.n. 151, 92. On the general rule as to priority between competing creditors claiming through after-acquired property clauses, see GOODE, p. 556 (by dates of their agreements).

236. See ZIEGEL, *op. cit.*, f.n. 204, 105-07.

debtor must for an instant at least have held absolute title in the proceeds on which the prior chattel mortgagee's after-acquired property clause could fasten to give that secured party a prior equitable interest.

The *PPSA*'s purchase money security interest priority rules are its analogue, but with an extension to proceeds, of the priority position of the conditional seller at common law. There are in fact three separate rules for purchase money security interests, which interests are not, however, limited of those of conditional sellers.[237] Only two of the rules are of concern here: both give purchase money security interests in collateral or its "proceeds" "priority over any other security interest in the same collateral." "Proceeds" is defined in material part for the purposes of the *PPSA* as "personal property in any form or fixtures derived directly or indirectly from any dealing with collateral or proceeds" (section 1(r)). The two special priority rules have different sets of qualifying conditions. One set, for the rule dealing with purchase money security interests in "inventory" (defined in section 1(n) to include "raw materials"), is more onerous than the other set, for the rule dealing with such interests in collateral or its proceeds "other than inventory." If these rules are not complied with, the relevant security interest is remitted to the residual priority rules, of generally speaking order of filing (section 35(1) (a)). The inventory qualifying rules require first, that the purchase money security interest be perfected at the time the debtor received possession of the collateral. Second, the secured party prior to that receipt must have given notice in the prescribed form to any other secured party who was actually known to the purchase money supplier or who had registered a financing statement covering the same items or type of inventory (section 34(2)). By contrast, the non-inventory qualifying rules are limited to a requirement for perfection "at the time the debtor obtained possession of the collateral or within ten days thereafter" (section 34(3)).[238]

There are however three complications in our problem not yet dealt with which could affect the picture just painted. One is the fact that as to the inventory security interest here there is a question of manufacture of the original collateral. The second is as to the rules to be applied when one competing security interest is not a *PPSA* one at all, but a charge registered under the *CSRA*. The third is as to

237. See *PPSA*, s. 1 (s) (ii).

238. The two sets of rules are discussed, and the rationale for the difference between them is given, in McLAREN, *op. cit.*, f.n. 150, vol. 1, pp. 6-9 to 6-14.

the application of the *Bank Act* priority rule here. The last two will be covered later. The first is dealt with here.

As regards the manufacture complication, the common law appears to recognize much the same categories as the civil law: accession, being principally the annexation or incorporation of one chattel into another such that "one or both retain their separate identity" (compare adjunction)[239]; confusion, where two or more chattels "are intermingled in such a way that while their physical characteristics remain it is no longer possible to distinguish one from the other so as to determine who is the owner of which"[240] (compare ad mixture);and specification, where "one person by his labour converts the goods of another (with or without the addition of his own goods) into a wholly new product", which includes cases of "the commingling of two materials belonging to different owners"[241] (compare civil law specification). The common law in Canada recognized that if there can be removal of the accessory without significant physical injury to the principal part, there was no loss of ownership of the accessory to the owner of the principal part.[242] The common law on confusion was that where the parties involved were both innocent with respect to the confusion (including cases where they authorized it),[243] they took interests in common in the mass in the proportion in which they contributed to it.[244] The common law in Canada on specification is less clear than it is on the first two. But it appears to be that in the commingling situation the raw materials suppliers are treated as if they had authorized a confusion.[245] However, where a new product results from "the application of labour by one party to the materials of another without the addition of materials of significant value owned by him", the manufacturer apparently takes ownership in the product unless it can be reduced to its original state[246] (the manufacturer

239. R.M. GOODE, *Hire Purchase Law and Practice*, 2nd ed., 1970, p. 746.

240. *Ibid.*

241. *Ibid.*

242. *Firestone Tire & Rubber Co.* v. *Industrial Acceptance Corp.*, (1971) 17 D.L.R. (3d) 229 (S.C.C.).

243. See SLATER, "Accessio, Specificatio and Confusio: Three Skeletons in the Closet", (1959) 37 *Can. Bar Rev.* 597, 600.

244. Ibid.

245. GOODE, *op. cit.*, f.n. 239, 759.

246. *Id.*, 759, n. 12. *C.f. Borden (U.K.) Ltd.* v. *Scottish Timber Products Ltd.*, [1979] 3 W.L.R. 672 (C.A.). It would seem to be otherwise where the raw materials were appropriated without permission: *Nash* v. *Barnes*, [1922] N.Z.L.R. 303, 307-08.

who takes ownership must however compensate the raw materials supplier).[247] No question arises in the specification area of proportionate value contributions, it would seem.

The *PPSA* has its own rules in this field, however, which will displace the common law ones to the extent that they are inconsistent. Unfortunately the *PPSA* position is one of overlapping rules to inconsistent effects; while what is probably the pivotal rule has inherited at least two drafting defects (as we see it) of that rule's Article 9 model. The potentially applicable rules are the purchase money security interest one, a rule for "accessions" (section 37) and another rule for cases where goods "subsequently become part of a product or mass" such that "the goods are so manufactured, processed, assembled or commingled that their identity is lost in the product or mass" (section 38).

The rules as to purchase money security interests has already been discussed: it is capable of application here because of the definition of "proceeds" already referred to.[248] The rule as to "accessions" is expressed to be subject to the "product or mass" rule (in section 38) and to apply notwithstanding the special priority rule as to purchase money security interests in non-inventory collateral. The "accessions" rule is limited by the definition of "accessions". They are "goods that are installed in or affixed to other goods" (section 1(a)): the rule for them in a case where a security interest in that accession attached before it became such is that such security interest has priority as to the accession over the claim of any person in respect of the whole (section 37 (1)).[249] However, that security interest is subordinate to a number of parties who subsequently take an interest in or give value under an interest in the whole without notice of the security interest[250] — which notice can be provided by registration of a financing statement (see section 53(1) (a) (i)). The accession secured party may on default remove his collateral "if, unless otherwise agreed, he reimburses any encumbrancer or owner of the whole who is not the debtor for the cost of repairing any physical injury excluding diminution in value caused by the absence of the goods removed or

247. *Ibid.*

248. *Cf.* G. GILMORE, *op. cit.*, f.n. 213, vol. II, pp. 846-47.

249. For a brief discussion both of this rule and the one for an accession which was such before attachment of the security interest, see CATZMAN et al., *op. cit.*, f.n. 151, 164-65.

250. See *PPSA*, s. 37 (2).

by the necessity for replacement" (section 37(3)). The "product or mass" rule (in section 38) is that a perfected security interest in constituent goods "continues in the product or mass" and "if more than one security interest attaches to the product or mass, the security interests rank equally according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total product or mass."

The "accessions" rule has eliminated the common law "material physical injury" test, although it in effect continues it in another, cost/benefit form.[251] The "product or mass" rule has eliminated the common law's troublesome "specification" category. The product or mass rule prevails over the accessions one in case of conflict. But the inventory purchase money security interest rule might seem from the terms of the "accessions" rule itself to prevail over it — although the non-inventory purchase money security interest does not, an odd result. And both purchase money security interest rules are in clear conflict with the section 38 "product or mass" rule without (as in the *UCC*)[252] a provision clearly indicating which rule has priority. From a policy perspective there seems to be an arguable distinction between the resale and manufacture situation so far as proceeds priority is concerned: in the latter case, there will be a degree of dependence on the debtor's organization (the components he has assembled and/or labour) for the realization of the proceeds which is not essential to the 'mere' making of a resale. Hence, one could justify equal ranking for purchase money and non-purchase money security interests in the former situation (which is the position under the relevant "product or mass" rule under the *UCC*) while accepting a different rule in the resale one.

One constructional way of avoiding the application of the purchase money security interest rules to the "accessions" and "product or mass" cases exists. This is to say that the opening words of the provision of the *Act* (section 27(1)) providing for the continuation of a security interest in collateral into its "proceeds", which run "subject to this Act", exclude the "product or mass" provision from the former provision's purview. Hence, the purchase money security interest which continues under the "product or mass" rule is not a 'continued into proceeds' "proceeds" interest, and thus not covered by the special purchase money security

251. *Cf.* GILMORE, *op. cit.*, f.n. 213, vol. II, pp. 845 and 805-06.

252. See sec. 9-312 (1962 and 1972) and *id.*, 855.

interest rule.[253] However, not only is this awkward constructionally but it has the odd result that where a purchase money and a non-purchase money security interest in the same collateral are continued into the product or mass, the latter interest, which may be covered by a prior filing but had been subordinated by the purchase money security interest rule, is suddenly promoted to equal rank.[254] This latter result can also be avoided by a route suggested by one of the drafters of the Article 9 "product or mass" provision, but not without some difficulty.[255]

To this list of complaints about the drafting of the "product or mass" rule one might add another two criticisms, suggested by the drafter referred to. One criticism is that the rule does not appear to rank the competing security interests in proportion to the amounts secured.[256] This criticism appears to us to be just, and it seems to have taken the drafter of the most recently enacted provincial legislation of the *PPSA* type.[257] However, the other criticism which is also acted upon in that legislation does not seem to us to be as clearly merited. This criticism is that the proportions are based not on the total obligations secured on the product but on their respective 'contributions' thereto, which leaves room for labour and overhead.[258] It does not seem to us that in the manufacture situation it is self-evident that secured capital should predominate over all other inputs: the present *PPSA* rule and its Article 9 parent seem to be quite defensible in that respect.[259]

Two final points should be made about the sale proceeds here. One could have arisen in acute form in respect of the cash generated by the widget sale if it had been banked. That point is that the "proceeds" rule in the *PPSA* appears — although none too clearly —

253. The language of *The Personal Property Security Act*, Bill No. 42 of 1979-80, ss. 34 (1) and 28 (1) (Sask.) might be seen more clearly to support such an argument than the *PPSA*.

254. *Cf.* GILMORE, *op. cit.*, f.n. 213, vol. II, p. 855.

255. *Id.*, 856 (say that the security interest attached not to the goods but to the debtor's "equity" in them). The trouble with his solution is its dependence on the very title based notions the Article 9 and the *PPSA* were at pains to dethrone in the priorities area.

256. GILMORE, *op. cit.*, f.n. 213, vol II, p. 853.

257. *The Personal Property Security Act.* Bill No. 42 of 1979-80, s. 38 (2) (Sask.).

258. GILMORE, *op. cit.*, f.n. 213, vol. II, p. 852-53.

259. Saskatchewan has gone the other way, however: see *The Personal Property Security Act*, Bill No. 42 of 1979-80, s. 38 (2).

to require the proceeds to be "identifiable or traceable" before a security interest in them can attach or be perfected.[260] The "traceable" wording appears to import the common law and equitable rules as to tracing. These are quite intricate, and need not be explored here,[261] except to note that one of them is that payment into a bank account into which other funds have been paid to which other secured interests laid claim does not result in loss of traceability. In particular, the rule where the funds are mixed with those of another with a similar right is that the secured party's claim becomes a *pari passu* one with that other.[262] Where the funds are kept separately both tracing law and the *PPSA's* unexpanded upon term "identifiable" would appear capable of preserving an interest for the secured party.

The other point goes to the priority rule to be applied with respect to the proceeds interest following the sale of a manufactured product. Neither the "accessions" nor the "product or mass" priority rule speaks to proceeds. It would seem as plausible on the arguments so far to say that the applicability of the purchase money security interest rule revives as to say that the residual priority one does. There seems little room for the argument (which makes the most sense) that as between competing section 38 interests their priority (subject to section 27(2)) continues into the proceeds.[263] This is hardly satisfactory.

3.6. The Accounts Receivable Financer

The pre-*PPSA* law, like the civil law, distinguished between the assignment of accounts receivable and their use as security. This distinction was in terms of that between an absolute assignment and a charge or an assignment by way of security.[264] The common

260. See *PPSA*, s. 27 (2) (which on its face applies to perfection only). A threshold question is whether "proceeds" includes cash (in the sense of tender): our view is that it does, on the basis of s. 1 (r)'s definition of "proceeds". See generally McLAREN, *op. cit.*, f.n. 150, vol. 1, pp. 4-1, 4-2. The latter page discusses "identifiable or traceable".

261. See for useful analyses R. GOFF & G. JONES, *The Law of Restitution*, 2nd ed., 1978, c. 2; GOODE, "The Right to Trace and Its Impact in Commercial Transactions", (1976) 92 *L.Q. Rev.* 360, 528; and the discussion in ZIEGEL and CUMING, *loc. cit.*, f.n. 188, 39-42.

262. See D. WATERS, *Law of Trusts in Canada*, 1974, pp. 893-94 and see McLAREN, *op. cit.*, f.n. 150, vol. 1, p. 4-2.

263. This is because one could argue that where the *PPSA* wants to extend a special priority rule into proceeds, it says so, as in s. 34.

264. See generally SYKES, *op. cit.*, f.n. 182, c. 16.

law did not recognize a "pledge" of accounts receivable like that in Quebec.[265] An assignment or charge could be of present or future accounts.[266] The absolute assignee, the chargee and the assignee by way of security all received the same treatment so far as priority and the right to collect from the debtor were concerned.[267] Until notice to the debtor, he could continue to pay the account creditor.[268] The assignee or chargee who gave notice first took priority, unless at the time he originally took his interest he had notice of a prior assignment or charge.[269] Strictly an assignment or charge did not have to be in writing, and the notice to the debtor could be oral.[270] However, certain procedural advantages in the collection of the debt may have enured in the case of assignments which were in writing signed by the assignor, and of which written notice to the account debtor was given.[271] There was legislation of the chattel mortgage and conditional sale type, *The Assignment of Book Debts Act*,[272] which voided against listed third parties unregistered assignments, absolute or by way of security, and charges (section 3).

The *Assignment of Book Debts Act* was repealed when the *PPSA* came into effect. The *PPSA* applies not only to a transaction creating a security interest but also "to every assignment of book debts not intended as security" (section 2(b)).[273] The identity in treatment is based on the functional identity of factoring with creating security interests in accounts receivable.[274] As a consequence of this conjoint application the same formalities and priorities rules apply to assignments not intended as security as to the security type in the case of "book debts". The *PPSA* formalities and priority rules have already been referred to. There seems to be no

265. But for accounts receivable in particular documentary form, it could approximate the civilian concept: see *id.*, 613.

266. *Id.*, 604-05.

267. *Id.*, 605-07, 687-89.

268. *Id.*, 598.

269. *Id.*, 688.

270. *Id.*, 598, 688.

271. Although this is not clear: see ONTARIO LAW REFORM COMMISSION, *op. cit.*, f.n. 217, vol. I. p. 120.

272. *The Assignment of Book Debts Act*, R.S.O. 1970, c. 33, as amended by S.O. 1972, c. 1, s. 24 and S.O. 1974 (2nd Sess.), c. 4 and repealed April 1st, 1976.

273. There is a corresponding expansion of the meaning of "security interest": see s. 1 (y), last line. "Book debts" is not defined in the *Act:* for a discussion of this, see McLAREN, *op. cit.*, f.n. 150, vol. 1, p. 1-5.

274. McLAREN, *op. cit.*, f.n. 150, vol. 1, p. 1-5.

convincing reason why a purchase money security interest in an account receivable cannot be created,[275] although the temporal sequence in our problem makes it unlikely that Friendly Finance has such an interest with respect to the accounts receivable in issue here.[276] It should be noted that under the *PPSA* a non-purchase money security interest accounts receivable financer would under the purchase money security interest priority rule take after the holder of a qualifying interest which had continued into accounts as proceeds, even if the former had filed first. Such a result in the case of accounts receivable generated by sales of inventory was perceived in the United States to be inappropriate, in view in large part of the relative importance of inventory and accounts receivable financing.[277] Such a position commended itself to the drafters of the other PPSA — type legislation in Canada, which explicitly immunizes accounts receivable financers in such situations against the inventory purchase money security interest rule.[278]

So far as the residual *PPSA* priority rule is concerned it is to be noted that it does not depend on notice to the debtor. Notice to the debtor is only of importance at the level of collection.[279]

When all of this is read against the *PPSA's* rules as to proceeds, referred to above, it is apparent that a priority conflict with aspect to the account receivable here could readily arise as against True Temper, with the rule of resolution being either the inventory purchase money security interest rule or the residual priority rule. A priority conflict could also arise against the debentureholders, if their 'floating charge' provision was expressed, as seems likely, to cover accounts. If their security agreement was structured as a *PPSA* one, the rule of resolution would be the residual one. If their security agreement was structured to bring them under the *CSRA*, much greater difficulty is experienced in resolving the conflict. How much more is explored below, as is the question of priority against the other likely claimant, Better Bank.

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275. For a discussion, see ZIEGEL, *loc. cit.*, f.n. 175, 71-73.

276. See *PPSA*, s. 1 (s) (ii) and WHITE & SUMMERS, *op. cit.*, f.n. 152, 1045-47. If it were a purchase money security interest priority would appear to fall to be determined under the residual priority rule in s. 35: see ZIEGEL, *loc. cit.*, f.n. 175, 75-77.

277. See GILMORE, *op. cit.*, f.n. 213, vol, II, pp. 796-97 (provided that accounts receivable financer gave "new value"); WHITE & SUMMERS, *op. cit.*, f.n. 152, 1040-41, n. 19.

278. *The Personal Property Security Act*, S.M., c. 5, as amended, s. 34 (3) (provided that accounts receivable financer gave "new value"); *The Personal Property Security Act.* Bill No. 42 of 1979-80, s. 34 (4) (Sask.) (same).

279. See *PPSA*, s. 40.

3.7. The Trustee for Debentureholders

The nature of the security agreement which is likely here, with its "specific mortgage and charge" and "floating charge", has already been described. If the arrangement is structured as a *PPSA* security agreement, resolution of the priority conflicts is a comparatively simple affair.[279a] One matter of interest is that the floating charge's prohibition on any prior or *pari passu* "mortgage, charge or other encumbrance" is likely to be transmuted into a withholding of subordination in the case of creation of security interests. This will catch what at common law would have escaped such clauses, conditional sales. Of course the *PPSA's* purchase money security interest rules might come into play here; but correspondingly, if the conflict is outside their purview, the effectiveness of the former prohibition will depend on the application of the residual priority rule or the "accession" or "product or mass" rule, not on the matter of "notice".

Much greater difficulty arises when the arrangement is considered as having been structured for and duly registered under the *CSRA*. The problem is similar to the one experienced with the landlord's right of distress, although there is even less assistance from the non-*PPSA* statutory context. The problem is to apply the common law priority rules to *PPSA* security interests. For it would appear that the common law rules are the ones that must be resorted to:[280] in the face of the *PPSA's CSRA* exclusion it is hard to see how the former *Act's* priority rules can be directly invoked.

The easiest case is the fixed mortgage and charge on the equipment. If Widgets had an absolute title to the boxing machine or the punch press when the debentureholders' agreement was entered into, their interest could have been a legal one. Such an interest would prevail over any subsequent *PPSA* claimant, such as

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279a. A very difficult priority issue arises with respect to the tender on hand if one adopts the view that an original security interest therein (as opposed to a proceeds one: see f.n. 260) cannot be created, under the *PPSA;* or if one can, that it cannot be perfected by registration (see ss. 24 and 25). See ZIEGEL, *loc. cit.*, f.n. 175, 72-73 and ZIEGEL and CUMING, *op. cit.*, f.n.188, 24-25. We are more taken by the second view than the first, but would avoid the issue by characterizing the debentureholders' security interest as here a proceeds one: *cf.* ABEL, *loc. cit.*, f.n. 187, 422, which suggests this escape will not always be available. *The Personal Property Security Amendment Act,* Bill — of 1980 (September 1980), if enacted, will climinate the problems: see cll. 1 and 10, following in the footsteps of Saskatchewan, as to whose legislation see ZIEGEL and CUMING, at page 25.

280. See ZIEGEL, *loc. cit.*, f.n. 175, 60-61, who notes some of the difficulties to which this could give rise.

Friendly Finance, because his security interest could not be any better for common law purposes than a legal one, and as later in time would rank lower. What would be the position as to subsequently acquired equipment, which would likely be caught by an after-acquired property clause in the fixed mortgage and charge provisions? It would depend in part on whether Widgets took a legal or a beneficial title. If Widgets took a legal title, the debentureholders' interest would on acquisition be an equitable one, subject to defeat at the hands of a later purchaser for value without notice (which it would seem *CSRA* registration would not provide) of a legal interest.[281] The debentureholders' interest could become a legal one but only when Widgets has performed some post-acquisition act which could be viewed as "designed to implement his promise [to confer a legal interest] and contemplated by the contract as being an act on the doing of which title would pass".[282] Merely bringing the property on to the factory floor would appear to be enough at least if that is the act expressly provided for.[283] If, however, Widgets took only an equitable interest, the interest of the debenture holders was limited to an equitable one also.

With respect to the punch press and boxing machine, determination of the nature of Widget's interest is unencumbered by the *PPSA*. With respect to the saw on conditional sale that determination makes it necessary to see if the *PPSA* affects the issue. The Canadian common law appears to have seen the nature of a conditional buyer's proprietary interest as equitable only.[284] The *PPSA* for its purpose recognizes the functional identity of the conditional sale with the chattel mortgage, under the common law analysis of which the buyer could be seen as having had legal or beneficial title which he transferred to the mortgagee by way of security.[285] The *PPSA* does not distinguish between legal and beneficial interests for its purposes. Is the effect of all of this to make the *PPSA* conditional buyer's title legal?

The answer to this is considered to be no. The reason is the *PPSA's* "without regard to the person who has title to the collateral" in its major application section (section 2(a)). This position is

281. *Id.*, 60; and see f.n. 184 and accompanying text.

282. SYKES, *op. cit.*, f.n. 182, 449.

283. *Id.*, 449, n. 39.

284. See ONTARIO LAW REFORM COMMISSION, *op. cit.*, f.n. 217, vol. 1, pp. 40-41.

285. See *id.*, 43; SYKES, *op. cit.*, f.n. 217, 13-14, 17 and 444-53.

supported by what authority there is in Ontario[286] and by the view taken of the analogous *UCC* Article 9 provision in the official comment thereto.[287] It may be correct to argue that the *PPSA* reinforces the trend in the common law to characterize the conditional buyer's interest as beneficial ownership.[288] But it does not seem correct to say in the face of the words quoted that it has changed the locus of legal title.

But if it is not correct to say that the conditional buyer's interest is legal, is it correct to argue that a later *PPSA* security interest created by such a buyer is a legal one? At common law, the answer would have been no: *nemo dat quod non habet*.[289] But the *PPSA* security interest is one *sui generis* which the common law must characterize. It would be tempting to describe a security interest which has attached — or at least which has been perfected — as a legal one, to reflect the priority superiority accorded to it (which is generally speaking not dependent on notice).[290] Policy arguments point both ways. Making the security interest (in Friendly Finance's case, not even of the purchase money sort) a legal one could here defeat a prior registered interest — albeit one registered under a different *Act*, registration under which should perhaps be discouraged. Making the security interest equitable creates the possibility of a later registered *CSRA* interest acquired after the buyer took legal title but before he performed a *novus actus* taking priority over an earlier registered *PPSA* one.[291] In the face of this, the common law could not, it is submitted, be faulted for following through on the legal interest analysis in the previous paragraph, to say that whether a *PPSA* security interest, registered or not, is legal or beneficial depends on what the debtor could create.

But what of the position of this conditional seller *vis-à-vis* the *CSRA* debentureholders? The analysis already undertaken would

286. *Rogerson Lumber Co. Ltd.* v. *Four Seasons Chalet Ltd.*, (1979) 1 P.P.S.A.C. 29 (Ont. H.C.), aff'd 29 O.R. (2d) 193 (C.A.). The reasoning in the lower court's decision appears clearly to be wrong however: see ZIEGEL, *loc. cit.*, f.n. 175, 65-66 and the text, later. The reasoning in the Court of Appeal seems some what better on this point.

287. See sec. 9-202, Comment (1962 and 1972).

288. See ZIEGEL, *loc. cit.*, f.n. 175, 66.

289. Although there were exceptions: see *e.g.* ZIEGEL, *loc. cit.*, f.n. 204, 76-96.

290. There are exceptions, however: see *e.g. PPSA*, s. 34 (2) (inventory purchase money security interest).

291. Unless *PPSA*, s. 53 (1) (a) (i) (registration is "notice") or s. 9 (effectiveness against third parties) fills the breach: in light of *PPSA*, s. 3 (c) and *CSRA*, s. 15 it is submitted that the answer to that is no.

suggest that he retains his common law superiority, for the common law reason: title retention. But what of the situation when the collateral is processed or manufactured, or when it is resold? It will be recalled that in the last case the better view may have been that the conditional buyer was seen to resell as principal unless he was authorized to resell as trustee or agent, and that this could let in as a prior equity a chattel mortgagee's interest under an after-acquired property clause. The *PPSA,* as has been seen, simply "extends to the proceeds" the security interest in the original collateral, suggesting no discontinuity. This seems more compatible with the parties' intentions than the common law position.[292] However, its continuation of the conditional seller's original priority into the proceeds in the common law context is arguably not necessary from a policy standpoint: the original common law position had the merit of allowing earlier accounts receivable financers as well as chattel mortgage ones in.[293] That policy position did not however appear to find favour with the *PPSA* drafter, as has been explained. For that reason, and in the face of the *PPSA* provision quoted, it is suggested that a common law court would accept the *PPSA's* characterization of the life cycle of its security interests even though that has the priority effect at common law indicated.

All of this suggests the proper approach to the manufacture situation. As we saw, the common law in two situations permitted the apparent expropriation of a security interest in raw materials: where there was an accession, but separation could not occur without inflicting significant physical injury on the principal part; and where there was specification, and the product could not be reduced to its original tangible constituent. The question also arose at common law whether even if the conditional seller creditor's interest continued there was a hiatus analogous to the one in the authorized resale of goods under conditional sale which would let in other secured creditors with apt after-acquired property clauses. There is reason to think,[294] in the absence of Anglo-Canadian authority,[295] that there would be such an analogous hiatus. The *PPSA* provisions on proceeds, accessions and "product or mass" share a common thread: extension of the original security interest

292. See ZIEGEL, *loc. cit.*, f.n. 204, 107.

293. *Cf.* the references in f.n. 277.

294. *Cf.* ZIEGEL, *loc. cit.*, f.n. 204, 105-07.

295. *In re Bond Worth Ltd.*, [1979] 3 W.L.R. 629 (Ch. D.) and *Borden (U.K.) Ltd.* v. *Scottish Timber Products Ltd.*, [1979] 3 W.L.R. 672 (C.A. offer some support. But there is contrary American authority: see GILMORE, *op. cit.*, f.n. 213, vol II, pp. 843-44.

notwithstanding the subsequent transformation. It is considered that the common law would accept this position for the conditional seller's security interest *vis-à-vis* prior security interests *via* their after-acquired property or floating charge type provisions. The same analysis would dispose of the question of the priorities in the accounts receivable and cash generated by the products' sale.

All of this analysis assumes, however, that it is possible to distinguish a conditional sale or title reservation type *PPSA* security agreement from a chattel mortgage or equitable mortgage title transfer arrangement. The difficulties in making that distinction have already been canvassed in relation to the landlord's right of distress.

It can hardly be pretended that the chain of analysis above can confidently be put forward as the most likely answer to the priority issues canvassed. The intricacy and speculativeness of the analysis, as well as the difficulty of the matters for whose resolution it calls, simply confirm the unwisdom of having parallel consensual personal property security systems like the *CSRA* and *PPSA*. This matter has been under active study in Ontario,[296] and it appears to have persuaded the drafters of the later provincial *PPSA* — type acts to integrate the arrangements covered by *CSRA* — type statutes into the *PPSA* sheme.[297]

3.8. Security under the Bank Act

The nature of this security and the priority provisions applicable thereto as matters of federal law have already been discussed. It remains to be seen how their implications are to be traced out in Ontario by comparison with the position in Quebec.

The common law like the civil law has treated the bank holding section 88 security as succeeding to the ownership position of the debtor. There appears however to be less difficulty rationalizing this at common law: a ready analogy can and has been found in the chattel mortgage.[298] With respect to a section 88 security over inventory

296. Culminating in *The Personal Property Security Amendment Act*, Bill — of 1980 (September 1980): see first two pages of Explanatory Notes of the Bill.

297. See *The Personal Property Security Act*, S.M. 1973, c. 5, as amended, ss. 1 (f), 47 (3), 48 (5) and 52 (4); *The Personal Property Security Act*, Bill No. 42 of 1979-80, ss. 3, 4, 44, 45 and 48 (Sask.). *UCC* Article 9 does not distinguish the special case of long term corporate debt, a model Saskatchewan but not Manitoba seems to have followed (although consider s. 48 of the Saskatchewan *Act* as applied to such debt).

298. See I. BAXTER, *The Law of Banking and the Canadian Bank Act*, 2nd ed., 1968, pp. 215-16.

it would appear that from the nature of the collateral it could be argued that the debtor has the implied consent of the bank to sales in the ordinary course of business free of the bank's interest.[299] However, any proceeds are taken to be acquired on the bank's account.[300] Priority in respect of the proceeds falls to be determined by provincial law, it would seem, at least as regards proceeds not themselves of the section 88 type.[301] However, the derivation of the bank's interest in proceeds would suggest that at common law there is no *hiatus* in which a secured creditor's after-acquired property clause could operate to displace the bank.[302]

There remains for consideration the question of the bank's priority position *vis-à-vis* interests in section 88 collateral arising under arrangements concluded before it took its security. As regards conditional sellers there is a body of authority to the effect that the bank will take section 88 collateral acquired by a conditional buyer free of the title of the conditional seller if the conditional sale agreement was not registered under legislation like *The Conditional Sales Act* of Ontario (now repealed).[303] The rationale of those decisions appears to be that a conditional buyer's interest is sufficient to constitute him "owner" for the purpose of giving a section 88 security. (There is a decision under the *PPSA* to a contrary effect which seems clearly to be wrong.[304]) Having thus established its ability to take that interest under section 88, the bank could also take advantage of provincial law capable of application to it (such as the conditional sales legislation referred to) which immunized it from other claims in respect of the property to which the bank's debtor, and original "owner" of the section 88 collateral, was subject.[305] This reasoning would seem capable of extension to provincial

299. See *Bank of Montreal* v. *Guaranty Silk Dyeing and Finishing Co. Ltd.*, [1935] O.R. 493, 508 (C.A.) read with ZIEGEL, *loc. cit.*, f.n. 204, 77; but see also *Hurly* v. *Bank of Nova Scotia*, (1966) S.C.R. 83, 86 (dictum).

300. *Cf. Re Canadian Western Millwork Ltd.: Flintoft* v. *Royal Bank of Canada*, (1964) S.C.R. 631 esp. at page 635.

301. See ZIEGEL, *loc. cit.*, f.n. 204, 68-69; *Re Canadian Western Millwork Ltd.: Flintoft* v. *Royal Bank of Canada*, (1964) S.C.R. 634-35. On proceeds which are s. 88 collateral, see *Re DeVries and Royal Bank*, (1975) 11 O.R. (2d) 583 (C.A.), aff'g 8 O.R. (2d) 347 (H.C).

302. See ZIEGEL, *loc. cit.*, f.n. 204, 105-06.

303. See ZIEGEL, *loc. cit.*, f.n. 175, 63, n.34.

304. *Id.*, 65-66.

305. See *e.g. Royal Bank of Canada* v. *Hodges*, [1930] 1 D.L.R. 397, 398, 399 per C.J.A. Macdonald (B.C. C.A.).

priority rules under which the bank could quality.[306] Thus, taking pre-*PPSA* law, in the case of a contest between a bank's after-acquired property clause in its section 88 security agreement and that of a non-bank creditor with a clause of overlapping scope, in respect of goods in which the debtor acquired a legal title, the bank would take in priority unless the non-bank creditor's agreement was earlier and the bank had notice of it. This is because the bank by virtue of section 88(2) (a) would appear to acquire a legal title on the debtor's acquisition of it, contrary to the common law rule.

Applying this to the trustee for the debentureholders on the assumption that the arrangement is registered under the *CSRA*, the bank would rank behind their interest.[306a] This is on the assumption that the *PPSA* does not make a conditional buyer's interest a legal one and on the assumption that the *PPSA* security arrangements between the various suppliers and Widgets here are characterized as conditional sales. The first assumption as we saw is not, and the second assumption as we also saw may not be, without their difficulties.

So far as Friendly Finance is concerned, its *PPSA* security interest falls squarely within *Bank Act* section 89(1). Thus, notwithstanding the bank's possible non-perfection of its security interest under the *PPSA*, it takes priority.

So far as the steel conditional seller is concerned, on the argument rehearsed above we must apply the *PPSA* priority scheme at the time Widgets acquired its 'ownership' of the collateral — which could appear to be no later than when it entered into the agreement with the supplier. Assuming that the agreement was characterized as a conditional sale, that the debtor received possession of the collateral at the same time as he became "owner" thereof and that the relevant qualifying conditions were satisfied as to the bank to the extent they were applicable,[307] the supplier could take priority over the bank as to the original collateral.[308] If one or other of the second and third assumptions is not met, then the relevant priority

306. But see ZIEGEL, *loc. cit.*, f.n. 204, 63 and case cited in f.n. 286, *supra*. We do not think that a conditional seller's interest is an "unpaid vendor's lien", within *Bank Act*, s. 89 (1), in part in light of the civilian authority we have discussed and in part because of the common law usage (e.g. in *The Sale of Goods Act*, R.S.O. 1970, c. 421, s. 37). However, the matter is hardly beyond argument: see ZIEGEL, p. 63.

306a. But see *Re Castell and Brown Ltd.*, [1898] 1 Ch. 315 which would suggest that the bank should have priority.

307. On a strict reading of *PPSA*, s. 34 (2) that may not be enough if there are other security interests actually known to the supplier or previously registered.

308. But see ZIEGEL, *loc. cit.*, f.n. 204, 63, 64.

rule with respect to the original collateral the steel on hand would be the residual one. Unless the possession of the secured party at the time the debtor acquired 'ownership' is perfection by possession — which seems unlikely[309] — or the bank made a *PPSA* filing in respect of its section 88 security in due time, priority will be determined by the order of attachment of the parties' security interests (section 35(1) (c)). *Ex hypothesi* this would leave them ranking equally.[309a] If the supplier was able to file before the execution of the security agreements[310] and before the bank it could win under the first to file or perfect rule (section 35(1) (a), (b)); however, as was seen, the *PPSA* prevents such prior filing except in the case of collateral consisting of "goods to be held for sale or lease" (section 47(3) and (2)) (*i.e.* not for manufacture).

So far as concerns the steel conditional seller's claim on the manufactured goods, it seems clear that whatever else happens, the bank's security interest continues, by force of *Bank Act* section 89(5). The same would seem to apply to the conditional seller's interest by force of the *PPSA* provisions discussed above. If True Temper had a purchase money priority over the bank, its continuation into the manufactured product, and its sale proceeds are a matter of some obscurity, as has been seen. This is because of the awkward overlapping of the relevant *PPSA* rules.

If True Temper had no purchase money priority, but initially ranked equally with the bank on the argument already rehearsed, then it is submitted that this position would continue up to the stage of sale of the product. At that point the "accession" and "product or mass" rules cease to operate. It would seem then that the rule of priority applicable to the proceeds again becomes the residual one — but applied as of the date of decision. It could then be argued that a filing by True Temper in due time, which would be ineffective as to the bank so long as the collateral was unsold (*Bank Act,* section 89(1)), could displace the bank with respect to the proceeds. Such a result has little to commend it except its conformity with the relevant legislation.

The last priority resolution discussion is relevant to the accounts receivable financer, of course. If Angrignon Acceptance

309. *Cf.* CATZMAN et al., *op. cit.*, f.n. 151, 121 (indicating possession must be referable to status as secured party).

309a. But see *Rogerson Lumber* v. *Bank of Montreal*, (1980) 29 O.R. (2d) 193 (C.A.).

310. It is submitted that filing afterwards with priority effect would be inconsistent with *Bank Act*, s. 89 (1); but see later in the text, as to proceeds. *The Personal Property Security Amendment Act*, Bill — of 1980 (September 1980), cl. 16, if enacted, would confer this ability.

can perfect by filing under the *PPSA* before the bank, then that discussion would suggest it should take priority.

As with the analysis of the *CSRA* — registered debentureholders' position, this chain of argument with respect to the position of the bank's security *vis-à-vis* at least the conditional sellers' *PPSA* security interests here cannot be put forward with a great deal of confidence. At least some of its links are matters of some controversy.[311] Again the unwisdom of having parallel unintegrated consensual personal property security systems is borne out. At the very least a problem of having to make not one but two chattel security searches, in different places, creates inconvenience for later secured creditors.[312] Harmonization of the *Bank Act's* section 88 security system or its elimination has been recommended at least as far back as the last "decennial" revision of the *Act.*[313] Unfortunately, it would seem that the latest proposed revision would continue the *status quo,* which has prompted a further call for reform.[314]

3.9. Conclusion

Unlike Quebec, Ontario has in the *PPSA* what purports to be a comprehensive law setting up a uniform system of security interests on moveables. As we saw the integrity of the scheme is seriously compromised by the *CSRA* to which it expressly defers and the *Bank Act's* section 88 security system which it is powerless to override. Subject to those two major detractions, the *PPSA* presents a single security interest concept of considerable flexibility, although there are some weaknesses, major and minor,[315] which our discussion highlighted. Perhaps the single most significant such weakness is the priority rule coverage for the security interests over raw materials supplied to manufacturers. Subject to that detraction the PPSA was seen to offer a unified computerized registry system for the perfection of non-possessory security interests around which

311. See ZIEGEL, *loc. cit.*, f.n. 204, 62-63, 64.

312. BAXTER, *op. cit.*, f.n. 298, 222.

313. In *id.*, 222-23, 232.

314. See Canadian Bar Association, Committee on a Model Uniform Personal Property Security Act, *Submission to the Committee of the House of Commons on Finance, Trade and Economic Affairs on Bill C-57, an Act to Revise the Bank Act, etc.*, 1979. The position there criticized was not remedied in *Banks and Banking Law Revision Act,* Bill C-6, 1980, 1st Sess, 32nd Parl., 29 Eliz. II, 1980 (first reading); see cll. 178, 179 — in fact, cl. 178 (1) appears to very much extend the scope of present s. 88 (1).

315. "Minor" defects were relegated to footnotes. See e.g., f.n.n. 162, 224, 260.

is organized a system of coherent comprehensive priority rules for such interests. And at the level of enforcement the *PPSA* offers a uniform, coherent scheme of remedies which appears to represent on major points a reasonable balance of protection for creditors and debtors.

It requires a considerable effort to come to terms with a complex integrated scheme like that of the *PPSA*. Such a coming to terms demands not only a parsing of statutory language but also a drawing out of purpose and policy which can illuminate the otherwise obscure. The judicial record on the handling of the often complex problems thus far brought to court, when measured against this standard, must be accounted a mixed one.[316] It stands as a reminder of the problems thrown up by the need for cooperation between the commercial law reformer and those who must live with his product.

4. Conclusion

4.1. Reform of the Law Relating to the Financing of Moveables

We have seen that the impact of the legal system of Quebec and Ontario on our problem is complex and in many aspects uncertain or simply unsatisfactory. Both systems suffer from a lack of integration of the relevant law. This is perhaps surprising for Ontario since its *Personal Property Security Act* was borrowed from Article 9 of the *Uniform Commercial Code*. In one respect the lack of integration is beyond provincial control: the *Bank Act's* section 86 and section 88 security systems are immune from provincial repeal. Our analysis shows the extent to which two provinces with different legal traditions have common cause to seek, in consultation with federal authorities, a redress of this situation. We favour abolition of section 86 and section 88 security in favour of a general provision empowering the banks to seek whatever security is available to them under provincial law. We see no warrant for a special priority

316. A significant *corpus* of acute commentary is represented by the word of Professor Jacob Ziegel of the Faculty of Law, University of Toronto published in the *Canadian Business Law Journal*: see "The Transitional Provisions of the Ontario Personal Property Security Act: *In re Galaxie Family Restaurant*", (1977) 1 *Can. Bus. L.J.* 375; "Defects in Registration under the Personal Property Security Act — Has the Pendulum Swung Too Far?", (1978) 3 *Can. Bus. L.J.* 106; "PPSA Registration Problems", (1979) 3 *Can. Bus. L.J.* 222; *loc. cit.*, f.n. 175; "Detrimental Reliance and the PPSA", (1980) 4 *Can. Bus. L.J.* 249.

regime for banks; in this respect we draw on the wisdom of the Quebec Civil Code Revision Office's premise of equality of creditors.

We do not however favour remitting the banks to a legal regime unless it is at least as accomodating to flexible security as section 88. In this respect we have some reservations about the Quebec situation which we do not feel about that in Ontario. If the Civil Code Revision Office's proposed reforms of Quebec law were awaiting the bank as enacted legislation, these reservations would no longer be as justifiable. We shall return to this point shortly.

While the *Bank Act* problem cannot unilaterally be overcome, we see no such obstacle standing in the way of abrogation of the *Special Corporate Powers Act* regime in Quebec or the *Corporation Securities Registration Act* regime in Ontario. However, we would have reservations about remitting the Quebec creditor, who formerly brought himself under the special regime, to present Quebec law which are similar to those we felt on the banks' behalf. The problem that remission of the Ontario creditor to the *PPSA* regime has been said to raise, that of renewing registration for long term security, seems to us to be exaggerated. This potential problem appears to have concerned neither the drafters of Article 9, nor the Civil Code Revision Office in its proposal to introduce a new unitary regime to Quebec. In any event the problem, if problem it is, only seems to us to warrant inclusion of a provision which stipulates an indefinite registration effectiveness period.

The problem of non-consensual security devices in the two jurisdictions, epitomized by our landlord and his claim for unpaid rent, is further cause for reform. In this respect we favour the position of the Civil Code Revision Office, which has recommended abolition of all the non-consensual privileges (liens, charges, rights of retention and preferences for payment) which the years have thrown up. We do not see why the nature of the creditor or his claim should confer the special priority position which both Ontario and Quebec now recognize. Once again however, we would be happier about remitting the special claimant to the present Ontario regime than that which prevails today in Quebec.

We have said enough already to indicate that when we say we favour a unitary personal property security law regime, we mean a regime which is accomodating of the diversity of commercial situations to which it must cater. A model of such a law is Article 9 of the *Uniform Commercial Code*. This is the view in Ontario; it is also the view of the Civil Code Revision Office.

4.2. Pitfalls in the Civil Code Revision Office Recommendations

In the proposed Code revisions we find a single security concept (the hypothec); a hypothec identification rule which prefers substance over form rules for the creation and protection of hypothecs, including creditor possession and registration rules which give publicity and largely determine rank, and which are eminently hospitable to the non-possessory security; rules reinforcing this which permit hypothecs to secure future advances and to cover after-acquired property and which extend the hypothec "to all subsequent accessions and improvements to, and increases in, the hypothecated property"; and a uniform remedial scheme, with rights of seizure, sale and taking in payment.[317]

Our analysis of our problem causes us to question some of the proposals however. We are troubled by the failure explicitly to address the problems created by manufacture and resale; we regret that there is no apparent allowance for registration before grant of hypothec; we are surprised that there is recognition of a special priority for the vendor's purchase money security interest but not the (functionally identical) lender's one; and we see only an imperfect resolution of the problem created by the immobilization by nature/immobilization by destination dichotomy.[318]

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317. See *Draft Civil Code*, 1977, Book Four, Articles 280 (single security concept); 281 & 282 (hypothec identification rule); 317 (creation rule); 375-401 ("publication" by possession or registration); 459-471 ("rank" rules); 301 & 302 (and see also 335-337) (future advances); 294, 306, 326 & 327 (after-acquired proprety); 297 (extension of hypothec: source of quotation in text); and Chapter VII (remedial scheme). For comments on the proposal see CARON, "La loi des pouvoirs spéciaux des corporations...", (1976) *Meredith Memorial Lectures* 81; GODIN et al., "Droit immobilier — Congrès du Barreau 1976", (1976) 36 *R. du B.* 385-404; LEBEL et LEBEL, "Observations sur le Rapport de l'Office de Révision du Code civil sur les sûretés réelles", (1977) 18 *C. de D.* 833; LEGARE, "Le Rapport sur les sûretés réelles: un droit futur emballant", (1977) 79 *R. du N.* 433; COMTOIS, "Le nouveau droit des sûretés réelles", (1978) *C.P. du N.* 75.

318. It seems to us that none of the *Draft Civil Code*, (1977) Article in Book Four, Title Five covers manufacture or resale proceeds; and the "publication" of hypothec rules in Chapter V appear to us to presuppose grant of a hypothec; the protection of the vendor's hypothec is in articles 460 and 463; finally, the question of immobilization by destination immobilization by nature is treated in Book IV, Title One, articles 3-12, especially articles 7-10. Our further explicit development of these criticisms must await a future article.

4.3. General Observations on Comparative Law Reform in the Commercial Field

We conclude this analysis of the law relating to the financing of moveables with several general observations. First, while the trans-jurisdictional character of commercial law makes uniformity of the law of security on moveables desirable, uniformity should not be purchased at the price of copying bad law. The proposals of the Civil Code Revision Office seem to have avoided certain residual problems with the Ontario version of Article 9. Nevertheless, the acknowledged weaknesses of Article 9 with respect to accessions in manufacture do not seem to have been remedied. It is not that the defects of the *U.C.C.* are merely formal (if indeed there are formal defects),[319] they are also substantive. Only a testing of the proposals of the Civil Code Revision Office against a variety of hypothetical problems, such as we have attempted here, will permit many potential defects to surface. While such an approach to law reform may not be conventional in civilian jurisdictions, in our view it is the optimal way to pretest any proposed legislative revisions to the rules of commercial law.

A second observation we would highlight relates to what may be described as the "one right rule" syndrome. Law reformers often become excessively preoccupied with finding *the* perfect solution to every possible problem. This preoccupation is translated into elaborate, systematic, self-contained models which simply fail to project themselves into the social situation they were designed to regulate.[320] It also results, especially in the commercial field, in the oversimplification of complex patterns of interaction and the glossing over of the importance of spontaneity and flexibility in legal relations. Sometimes law reformers must be content with "less than ideal" solutions simply because the extra intellectual *and* educational effort required to achieve perfection cannot be justified. While logic and aesthetics (not to mention the civilian tradition) may suggest that the law of security on property should be a coherent whole, be the object of the security interest a moveable or immoveable, commercial financing is so different than the financing of real estate transactions that the search for a comprehensive security device should be eschewed.

This leads us to our third observation. The law relating to the financing of moveables must be essentially facilitative. Except to

319. As Caron would seem to suggest, *loc. cit.*, f.n. 3, 375-377.

320. See FULLER, "The Law's Precarious Hold on Life", (1969) 3 *Ga. L.R.* 350. See also RAMSEY, "Book Review", (1980) 58 *Can. Bar Rev.* 480.

the extent necessary to prevent certain unconscionable transactions, the law of security on moveables must resemble corporation law, in which a great measure of flexibility is delegated to private parties operating within a general legal framework. In our view, both the *PPSA* and the Draft Civil Code are a step in the right direction. The law should seek to accomodate commercial practice, not to frustrate it; in this way "customary" commercial law will supplement, and not subvert "enacted" commercial law.[321]

A final point we wish to emphasize relates to the role of the law teacher. Here our remarks are directed more to the civilian than the common lawyer, although they are in some cases directed to both. Even though the law relating to the financing of moveables appears to be a branch of the law of security on property set out in articles 1966 — 2008 C.C. it is a mistake to view and teach this subject from such a perspective. Similarly, sections 86-90 of the *Bank Act* are, of course, a part of the law of banking, but they are also important in commercial financing. The sale of book debts can be taught as a part of the law of sale, but really belongs in a discussion of moveable financing. The provisions of the *Special Corporate Powers Act* relating to the trust for bondholders are not best dealt with in a corporation law course. It is encouraging that some functional unity is now appearing in the teaching of the law of security on property.[322] This new pedagogical tradition (borrowed particularly from the law schools in the United States) will ultimately be reflected in a more sophisticated and coherent law. It will also facilitate the successful adoption of any scheme similar to that proposed by the Civil Code Revision Office. For as we have seen, effective law reform presupposes sympathy and understanding from these who must employ the new legal tools placed at their disposal: the bench and bar.

It would be presumptuous for us to claim to have elucidated all the various contours of our topic. Nevertheless we feel that we have been able to suggest the utility and limitations of the comparative method of law reform in one important field: the financing of moveables.

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321. See LLEWELLYN, "Introductory Statement", (1954) 1 *N.Y. Law Rev. Comm'n. Rep. U.C.C.* 23.

322. See *e.g.* MARCOTTE, *loc. cit.*, f.n. 3.