

National Commercial Law Seminar Series
Personal Property Securities Act: Beyond the Transitional
Period □ □ □ □

Ordinary Course of Business and other Transferee
Rules

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Personal Properties Securities Act 2009

The Act is based on:

- * The New Zealand Personal Properties Securities Act 1999 which was based on the Saskatchewan Personal Property Security Act 1993
- * The Act has also been brought up to date with various concepts and rules from Revised Article 9
- * The Act is beset with problems and inconsistencies because of different terminology and idiosyncratic drafting and departure from the Saskatchewan Act - the best of the Canadian Acts.
- * All these matters make it difficult to comprehend and follow and therefore difficult to advise upon.

Introduction

- * Ordinary course of business rule – s 46 – mainly
- * Cut off provisions generally – Part 2.5 ss 41 to 53

Scenario

SP provides inventory to Grantor - Grantor provides GSA in inventory to SP

G sells to buyer

SP also has interest in proceeds s 31

G has been paid

Buyer has collateral for his or her use

SP is paid

If buyer bought on credit there is possibly a second SP

If all meet their obligations commerce flows

Against this background we have the PPSA priority rules

The priority and cut off rules tell us who wins

4 classes of competitor:

1. Unsecured creditors (includes judgment creditors)
2. Purchasers or buyers
3. Other secured parties
4. Trustees in bankruptcy, administrators and liquidators

- * PPSA focuses on the interaction between secured parties and general creditors and their representatives, and among secured parties themselves
- * The transferee or cut off provisions focus on when a grantor is able to pass good title to collateral to a third party free of a security interest
- * Under the prior law transactions of this nature were facilitated by the use of the floating charge. – ie the chargee had no property interest in the inventory (circulating assets) until crystallisation.

Policy considerations

1. Commercial certainty – first to file rule but note pmsi and subordination
2. Bright line rules – no intervention of equity or reasonableness
3. Commercial efficiency – no forms to fill in to file – notice only by financing statement lodged by electronic means
4. Commercial reliance – Secured Parties and dealers should search – consumers shouldn't have to rely on public records

Cut off provisions

- * Prevent a buyer/lessee from being dispossessed by a secured party without buyer/lessee knowing or having means to discover existence of a security interest.
- * Buyer/ lessee of TV should not have to search and obtain a release from secured party.
- * Buyer/lessee of a motor vehicle should not have to search the register when he or she buys from a dealer.
- * The cut off provisions are important in the context of a proceeds.
- * The cut off rules modify the *nemo dat* rule.

Main cut off provisions

- * Unperfected security interests – s 43
- * Serial number goods, missing or incorrect – s 44
- * Motor vehicles – s 45
- * Ordinary course of business rule – s 46
- * Consumer goods garage sale or *de minimus* rule – s 47
- * Currency – s 48

PPSA enacts 3 general rules that collateral is subject to security interest unless:

1. SI is unperfected – transferee gets clear title provided he or she gave value.
2. If SI perfected then transferee gets clear title if SP expressly or impliedly authorised the transfer.
3. If SI perfected and SP did not expressly or impliedly authorise the sale, the transferee takes subject to SP's SI.

Cut Off Rules focus on rule 3

Was the sale authorised?

Need to look at s 32

The battle is over if the sale was authorised

Tanbro Fabrics (NYCA) is an example of authorisation – Tanbro was a textile manufacturer that turned textiles into curtains. Occasionally, it sold unfinished blocks of fabric. NYCA found this was authorised by a course of dealing. Reasoning if grantor was ever to liquidate its secured debt the sale must be authorised. Implicit because fabric was inventory. Based on *Debrick v Ashdown* (1888) CSC.

If the disposal is authorised

It is only when a sale is unauthorised that the Courts need to resort to the cut off rules. This is rule 3.

SP's SI in the collateral is *severed* at the point of sale – buyer obtains full rights to personal property

Any SP claiming through the buyer also takes free

The main rule is found in s 43 (unperfected security interests)

A buyer or lessee of personal property, for value, takes free of an unperfected SI

The effect of the rule in relation to unperfected SI's is that a buyer must search – s 297 (constructive notice)

Knowledge of the existence of an unperfected SI will not affect the operation of the rule

The purpose of this rule is to protect buyers not in the ordinary course of business against SP's who fail to give buyers notice of their interests.

Main purpose of PPSA is notice filing and integrity of the register.

Note that there is no possession requirement in s 43.

Note that the cut off rules will **not** apply to a party who buys in order to become a secured party s 42.

Except in relation to investment instruments (s 50) and intermediated securities (s 51).

S 50 uses the term *purchaser*.

Purchaser is defined for the purposes of this section and includes a secured party.

S 51 uses the term *transferee*.

If a sale was unauthorised, then SP's remedies are:

1. Repossession
2. Conversion

Proceeds provisions in PPSA (s 31) allow SP to trace or follow the collateral.

A proceeds claim is restricted to collateral in substitution for the original collateral in which the grantor had an interest: s 31(3).

Proceeds are identifiable or traceable personal property.

Sale in the ordinary course of business

Section 46 provides:

46(1) **Main rule** A buyer or lessee of personal property takes the personal property free of a security interest given by the seller or lessee, or that arises under section 32 (proceeds – attachment), if the personal property was sold or leased in the *ordinary course of the seller's or lessor's business of selling or leasing personal property of that kind*.

(2) Exceptions Subsection (1) does not apply if:

(a) Personal property of that kind may, or must, be described by serial number – the buyer holds it as inventory or on behalf of an inventory seller or

(b) Buyer buys with actual knowledge that the sale constitutes a breach of the security agreement that provides for the security interest

Section 46 contains a number of conditions

1. Must be a buyer or lessee
2. Seller must be one in the business of selling personal property of that kind – eg a white goods seller
3. Without actual knowledge that the transaction violated an SP's rights
4. SI that the buyer is competing with must have been created by the seller or lessor
5. Must not be serial numbered personal property to be held by buyer as inventory or on behalf of a party who will hold as inventory

Note: No requirement of good faith (good faith limited to remedies)

Who is a buyer?

- Not defined – probably means a person who acquires the general property in the personal property (cf s 3 *Goods Act*).
- Buyer therefore does not cover the acquisition of a limited interest such as a lease or other form of bailment. (*Helby v Matthews* – agreement to buy imports an obligation to buy if none then no agreement to buy but not a lease of a piano on a monthly basis but it will become a sale when the last payment is made). Hence the inclusion □ of a lessee in the section.
- Distinction between buyer and lessee is redundant because of the terms buyer and lessee.
- Purchase for use and retail sale included (wholesale as well)

Buyer or lessee?

Section only applies if transferee is a buyer or a lessee

Buyer is used because purchaser includes a secured party (cf s 18 *Property Law Act* and common law)

Lessee has its normal meaning but includes a bailee or a hirer

Sold or leased

Sale – sold -

Lease , includes bailment and hire purchase– borrowed from UCC and Canadian statutes

What does sold mean? A sale?

Sells implies title has passed under a conditional sale agreement but See *Spittlehouse* (below)

There is no definition of sale in the PPSA. But note that title is not determinative: ss 12(1) and 273. Need to look to UCC 1-210(9) for guidance – transfer of title is not determinative of a sale.

The *Goods Act* defines sale as the passing of title to the buyer for a price (s 61).

Selling probably means that a seller engaged in selling.

Selling can be on a number of bases eg cash sale, conditional sale, lay buy, hire purchase (*Helby v Matthews* type)

Note sale includes a bargain (s 3). Need not have paid the purchase price.

Could include a trade in plus cash, forgiveness of debt, a swap of one item for another, returns and credit (see s 30(8) Sask – Table).

To come within the rule, usually personal property sold should come from seller's inventory but not necessarily.

Cannot be redundant equipment or rental cars sold off when business is car rental not sales.

Does not need to be main business of the seller, it can be a small part of the business so long as it is systematic.

A one off sale may not be but it is not necessarily excluded cf *Stockco v Gibson* at [67]

***Camco Inc v Frances Olson* (1979) Sask CA**

Demonstrates that the interpretation of an important provision of PPSA is consistent with justice and commercial utility.

Question was did the buyer of a condominium from developer have the protection of s 30(2) of the Saskatchewan PPSA?

Buyer bought appliances with his condominium – Court said it must focus on the ordinary course of the seller’s business – his activity not that in the market place. Even though strictly not part of its inventory and not bought from an appliance seller, it was part of its business to sell appliances with the condominiums and therefore it was in its ordinary course of selling goods of that kind and within the section.

Usually there must be clear evidence that the sale was part of a business enterprise.

Really the sale was not an isolated transaction.

Goods Act analysis

Royal Bank of Canada v 216200 Alberta Ltd

RBC held an SI in furniture inventory.

Some customers had entered into agreements to buy furniture that were to be obtained from the manufacturers.

Some had prepaid all or part of the purchase price but had not taken delivery.

A receiver was appointed. The receiver identified some furniture in the premises that corresponded with the description in some of the sales contracts.

The Court had to consider whether buyers could force the receiver to surrender the items of furniture on the grounds that the sale was in the ordinary course of business.

The main issue was whether the section applies only when property has passed.

Court of Appeal (Vancise JA) said must establish that a sale has taken place. This meant that title had passed.

Here the contracts related to sale of future or unascertained goods therefore title could only pass when the goods answering the description in the contract were *appropriated to* the contract. This is Rule 5 in s 23 *Goods Act*.

Non-Technical analysis

Spittlehouse v Northshore Marine Inc [1994] 18 OR (3ed) 60 (CA)

CA rejected RBC. Facts basically the same as RBC but it involved specific goods comprising a boat. Title to boat remain until full price paid. 90% of purchase price was paid when receiver appointed.

CA said Sale of Goods Act not relevant in the context of the PPSA. What was crucial was the intention in the contract of sale, the seller to sell and the buyer to buy the boat.

Specific goods mean goods identified and agreed upon at the time a contract of sale is made (s 3).

Future goods are defined to mean manufactured or acquired by the seller after the making of the contract of sale (s 3).

There are problems with fungibles such as gold and bottles of wine.

Note that title is not determinative – s 12(1) and s 273

Alberta Pacific Leasing Inc v Petro Equipment Alberta QB

Universal Cranes was primarily in the business of leasing cranes. It leased one of its 10 cranes with an option to purchase which was exercised by Petro. Two sales of this type were made in one year.

Court concluded said:

Universal preferred to own a crane and lease it out rather than selling it, but if a sale of a crane was deemed to be in the greater economic interest of Universal, it would be sold if a purchaser could be found. The sale of cranes under those circumstances can be treated as sale in the ordinary course of business of Universal.

Factors relevant to OCB sale

Fairline Boats Ltd v Leger [1980] 1 PPSAC 218 (Ont HC)

1. Where agreement made
2. Parties to the sale
3. Quantity of goods
4. Price charged

369413 Alberta Ltd Pocklington [2001] 4 WWR 423 (Alberta CA)

1. Nature and significance of the transaction
2. Reason for the transaction
3. Frequency of the transaction
4. Arm's length nature of the transaction

New Zealand cases

Stockco Ltd v Gibson [2012] NZCA 330

All above factors were considered and endorsed by O'Regan P for the CA

In *Stockco* the transaction was highly unusual. It was a transaction that was structured to provide a way of avoiding the need to obtain the consent of the Banks - in effect a private sale involving the sale and leaseback of livestock (4,000 heifers) used a first ranking security for two different financiers.

Two stage process at [50] and [52].

***Tubbs v Ruby* [2010] NZCA 353**

This case involved sale of timber between related entities to assist with cash flow but all sales were at market value.

The sale price at market value for cash enabled the CA to form the view that they were ordinary course sales.

The fact that the sales were to a related party was immaterial [36].

Unperfected Security Interests

A buyer or lessee takes free of an unperfected security interest

- * Buyer or lessee must provide value
- * Buyer or lessee cannot be a party to the transaction being cut off eg a hirer under a hire purchase agreement is not a buyer for the purposes of this rule
- * Buyer or lessee cannot benefit from this rule if certain property is prescribed by the regulations – none proposed
- * Notice of an unperfected security interest does not affect buyer or lessee's rights
- * **Note** different rules for serial numbered personal property

Motor vehicles

Buyer or lessee takes free from non-dealer if:

- * Buyer or lessee has provided new value; and
- * Motor vehicle is serial numbered goods; and
- * Search of register* between the start of the previous day and the time of sale did not disclose SI; and
- * Seller or lessor granted the security interest or grantor has lost the right to possession of motor vehicle

*consumer goods search by serial number only – all other grantors by name or serial number

Motor vehicles – continued

Buyer does not take free if:

- * Buyer or lessee is a dealer
- * Seller is an execution creditor
- * The buyer or lessee has actual or constructive knowledge of the security interest – means buyer must search

Note: s 297 (constructive knowledge)

Cf s 199 *Property Law Act*

Motor Vehicles - continued

Buyer or lessee takes free from a dealer if:

- * New value given
- * Vehicle is serial numbered goods

But does not take free if:

- * Buyer or lessee is a dealer
- * Sale by an execution creditor
- * Secured party had possession immediately prior to sale
- * Buyer or lessee has actual or constructive knowledge that sale or lease is in breach of seller/lessor security agreement

Consumer transactions

Garage sale or *de minimus* rule

Applies to:

- * Sale or lease
- * New value is given – refers to total new value
- * Buyer or lessee intends to use predominantly for personal, domestic or household purposes
- * Value of personal property must not be greater than \$5,000 or any prescribed higher amount
- * Value is the market value of the personal property at time of sale

Consumer transactions

Continued

Will not apply if:

- * Serial numbered personal property
- * Buyer or lessee has actual or constructive knowledge that the transaction is in breach of the security agreement
- * The buyer or lessee believes that the value of the personal property is greater than \$5,000

Currency

- * Holder of currency takes free of a security interest eg security interest in an ADI account – applies to a controlled account
- * Currency includes AUD and any other country's currency
- * Holder must not have actual or constructive knowledge of the security interest

Note s 25 - an ADI has control of an ADI account even if debtor retains right to direct dispositions from it

See also s 341(2) in relation to the control of accounts in the context of circulating assets and s 341A in relation to ADI accounts

Buyers, purchasers, holders

Different terms for different classes of personal property

- * Buyer not defined – same meaning as Sale of Goods Act – a person who buys or agrees to buy? This is not clear
- * Buyer not a purchaser in the sense used in the *Chattel Securities Act* or *the Property Law Act* – purchaser includes a mortgagee
- * Lessee has its usual meaning
- * Purchaser restricted to investment instruments – means a person who takes by sale, lease, discount, assignment, negotiation, mortgage, pledge, lien, issue, reissue or any other consensual transaction: s 50
- * Note the term *transferee* is used in relation to intermediated securities: s 51
- * A holder means simply a purchaser who receives currency or the holder of a negotiable instrument (cheques and bills of exchange)

Ordinary course of business

“Personal property sold in the ordinary course of the seller's or lessor's business of selling or leasing personal property of that kind”

- * Only applies to security interests of the seller or lessor
- * Won't apply to a trade-in sold without the consent of a pre-existing secured party
- * Applies to any personal property
- * No requirement for value or new value
- * Excludes cancellation or forgiveness of all or part of a debt despite no requirement for value or new value

Ordinary course of business

Continued

- * Won't apply to motor vehicles - s 45
- * Not limited to retail sales
- * Won't apply to serial number goods held as inventory
- * Does not apply if buyer or lessee has actual knowledge that sale violates terms of the security agreement
- * Does not apply to surplus equipment of the seller sold as inventory if seller does not deal in personal property of that kind

Ordinary course of business

continued

- * Could apply to goods sold that are not part of the seller's primary business, particularly in the case of recurring sales – eg *Tanbro Fabrics* case
- * Might not apply if not the usual or regular type of transaction of seller
- * Frequency of sale or usual practices in the particular industry not part of rule
- * Won't apply to bulk sales – eg *Estevan v Dyer Ford* case

NB: Rule expressly cuts off both the security interest and its proceeds

Security interest includes proceeds

- * Extension of the security interest to proceeds
 - statutory solution to a number of common law problems
 - ability of a secured party to enforce its security in collateral and its proceeds

- * Overcomes problems associated with:
 - change of position defence
 - bona fide purchaser defence

- * Removes evidential problems for purchaser and secured party

- * Proceeds entitlement not dependent on the terms of the security agreement

What are proceeds?

Proceeds are *identifiable* or *traceable* personal property resulting from a disposal of original collateral

- * *Identifiable* means capable of being followed
- * Traceable means capable of being traced

Include:

- * Cash
- * Trade-in
- * Exchange of personal property

What are proceeds?

Continued

- * Insurance payment, indemnity or compensation for loss or damage to collateral or its proceeds
- * Chattel paper, intangible property or a negotiable instrument

Includes first generation proceeds and second generation proceeds, etc

- * Debtor must have an interest in the proceeds
or
- * Power to transfer rights to secured party

Limitation to proceeds

- * Not available if debtor does not have an interest in the proceeds
eg SP has SI in D' s car. D sells car to B1. SP can enforce against B1 (if not cut off). Later B1 sells car to B2 and receives motor cycle as trade in. D never acquired interest in motor cycle
- * Does not apply on enforcement - s 140(2)(f)
- * Cut off because of express or implied authorization - s 32
- * Cut off because of ordinary business sale – s 46