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SIGNIFICANT PPSA CASES FOR 2009

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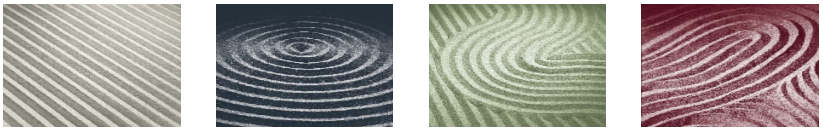

TABLE OF CASES

INTRODUCTION

In this portion of the program, we again address significant cases in Ontario relating to the *Personal Property Security Act (Ontario)* ("OPPSA"). The competing interests of registering and searching parties operating under the rules of the OPPSA and its equivalent statutes in other provinces continue to be issues in these cases over the years. This paper reviews cases in Ontario which have significant and broad impact upon users of the OPPSA. In examining those cases, this paper looks to reinforce best practices and make recommendations to legal practitioners from the lessons learned from the misfortune of others. Jurisprudence in Ontario continues to present useful roadmaps for users of the OPPSA system.

CASE: Fairbanx Corp. v. The Royal Bank of Canada et al.

Brief Summary of Facts

- A company by the name of Friction Tecnology Consultants Inc. ("Friction") entered into a factoring agreement with Fairbanx Corporation ("Fairbanx"). Friction assigned all of its accounts receivable to Fairbanx and Fairbanx filed an OPPSA statement perfecting its interest in a general security agreement, but in the filing of the statement spelled the debtor name with the word "Technology", as it should properly be spelled, i.e. with an 'h'.

- The evidence before the court was that all invoices, stationery, cheques and day-to-day documentation of Friction included the spelling of technology which included in the 'h', notwithstanding that the proper corporate name the spelling "Tecnology", being without the 'h'. There is no explanation in the recited facts of the case for this oddity.

- Thereafter Royal Bank of Canada loaned money to Friction, securing it with a general security agreement perfected under the OPPSA by registration. It took all property including accounts receivable and book debts. Royal Bank of Canada registered against the proper spelling of the name for its debtor, "Friction Tecnology Consultants Inc.". Friction thereafter went bankrupt.

- Prior to making its OPPSA filing, Royal Bank searched the correctly spelled name of Friction Tecnology Consultants Inc., and the security interests of Fairbanx were not revealed in the results of that enquiry response.

- This case then became a contest between Fairbanx and Royal Bank for priority in the bankrupt Friction's assets.

Issues

- Was the factoring agreement delivered to Fairbanx governed by s.53(1) of *The Conveyancing and Law of Property Act* (RSO 1990 (CLPA), chapter c.34 by virtue of their "absolute assignment" to Fairbanx, or does the priority scheme of the OPPSA apply?

- If the accounts are covered by the OPPSA, does the failure to register the correct name of "Friction Tecnology" mean that Fairbanx's interest is an unperfected security interest or may the error in registration be cured by s.46(4) of the OPPSA?

- If the registration error is fatal to perfection, did Fairbanx nevertheless perfect its security interest by possession?

Holdings of the Court

- Fairbanx argued it was the owner of the accounts receivable of Friction by virtue of s.53(1) of the CLPA. It argued that the OPPSA was usurped by the CLPA because of the absolute assignment of interest in the receivables under its' factoring agreement.

- Fairbanx then asserted that if they are wrong and the OPPSA does apply to this absolute assignment of interest in the accounts receivable, then the receivables are tangible personal property and Fairbanx could and did perfect its interest in those receivables by possession of such tangible personal property.

- Fairbanx then argued that if the OPPSA applies and its security interest was not perfected by possession, nevertheless the erroneous registration is cured by the s.46(4) of the OPPSA because a reasonable person would not likely be misled by the spelling error in the debtor name. As such, Fairbanx argued that it had a secured interest in the accounts the perfection of which pre-dated that of Royal Bank, giving it priority.

- The Court acknowledged that s.53(1) of the CLPA[1] applies to the assignment granted in the Fairbanx factoring agreement and security in support thereof. However, the Court found that the OPPSA also applies. The Court found that the words "If this session had not been enacted" in s. 53(1) of the CLPA although for the predominance of the OPPSA in the situation. Accordingly, it was the priority provisions of the OPPSA which were found to apply. The Court preferred applying one set of priority rules, being those of the OPPSA, to deal with major methods of inventory and receivables financing in such circumstances.

- An argument was made by Fairbanx to the effect that factoring agreements are not subject to the OPPSA. The argument was that the factoring agreement was an absolute assignment of the debtor's right, title and interest in the accounts receivable.

- The Court recognized that factoring agreements are not specifically identified and defined under the OPPSA. However, the Court did recognize that the factoring agreement in this case was an absolute assignment of all of Friction's right, title and interest in accounts receivable in exchange for the loan by Fairbanx to Friction. The Court found the factoring agreement was governed by the OPPSA

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[1] "53. **(1)** Any absolute assignment made on or after the 31st day of December, 1897, by writing under the hand of the assignor, not purporting to be by way of charge only, of any debt or other legal chose in action of which express notice in writing has been given to the debtor, trustee or other person from whom the assignor would have been entitled to receive or claim such debt or chose in action is effectual in law, subject to all equities that would have been entitled to priority over the right of the assignee if this section had not been enacted, to pass and transfer the legal right to such debt or chose in action from the date of such notice, and all legal and other remedies for the same, and the power to give a good discharge for the same without the concurrence of the assignor. R.S.O. 1990, c. C.34, s. 53 (1)."

and not the CLPA, and specifically cited s.2[2] of the OPPSA in that regard. The Court found that the act applied to the transaction in question, even thought it may not have secured a payment of an obligation by virtue of its absolute assignment. The Court cited s.39[3] of the OPPSA which provides that rights of the debtor may be transferred with our without the consent of a creditor, but no transfer prejudices the right of the secured party under the security agreement.

- The Court found that the decision in 2811472 Canada Inc. (cob "Acorn Partners") v. Royal Bank of Canada[4]. Acorn is cited for the fact that such factoring agreements are governed by the OPPSA although there is no formal definition of such agreements in the statue.

- Given that the OPPSA was held to apply, and that no exceptions under s.4 of the OPPSA[5] applied, it was the OPPSA alone that governed the issue of priority.

- The Court then found that accounts receivable are intangible property, and cannot be perfected by possession. Accounts receivable are not "instruments"[6] and do not constitute "monetary obligations". The OPPSA[7] was cited as authority to classify these accounts as intangibles, with the result that the Court found that there could be no perfection by possession in intangible property, including the property of these accounts.

- Having determined that the OPPSA applied, and that Fairbanx did not perfect by possession, the Court then dealt with the issue of curing the error and registration. It was argued that it was an immaterial error, and Royal Bank should not have been misled, in accordance with the test under s.46(4) of the OPPSA. The Court looked at the critical factor that, prior to advancing monies under its loan, Royal Bank had commissioned a certified inquiry response from the OPPSA registry. That enquiry response did not disclose the interests of Fairbanx, likely because of the spelling error. Accordingly, the Court recognized that the bank was in fact misled, and the curative of provisions of the OPPSA were not applied by the Court.

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[2] **"**2. Subject to subsection 4 (1), this Act applies to, (a) every transaction without regard to its form and without regard to the person who has title to the collateral that in substance creates a security interest including, without limiting the foregoing,..(b) a transfer of an account or chattel paper even though the transfer may not secure payment or performance of an obligation."

[3] **"**39. The rights of a debtor in collateral may be transferred voluntarily or involuntarily despite a provision in the security agreement prohibiting transfer or declaring a transfer to be a default, but no transfer prejudices the rights of the secured party under the security agreement or otherwise. R.S.O. 1990, c. P.10, s. 39."

[4] (2006), 81 O.R. (3rd) 721 (Sup.Ct.), aff'd by 2007 (Ont. C.A.) 150, (2007), 85 O.R. 490 [Acorn].

[5] Comprised of a list on non-applicable exceptions to the OPPSA.

[6] under s.22(1)(c) OPPSA.

[7] s. 20(1)(c) OPPSA.

Practical Significance for Lawyers

- Factoring agreements are governed by the OPPSA, and that has now been determined by two separate Ontario superior court decisions.

- All factoring agreements need to be registered under OPPSA, against the correct names. Perfection by possession cannot be achieved with collateral composed of accounts receivable.

- When searching for the correct name of the debtor, always rely exclusively on the Articles of Incorporation filed with the Ministry of Consumer and Commercial Relations, pursuant to a corporate search and not pursuant to day-to-day documentation of the debtor.

CASE: Bank of Montreal v. iTrade Finance Inc., 2009 (Ont. C.A.) 615

Brief Summary of Facts

- This is an appeal of a judgment in a case that pitted two innocent financial institutions against one another. Bank of Montreal ("BMO") and iTrade Finance Inc. were victims of a fraudulent scheme perpetrated by a common customer, "Mr. A." and his wife, together with his company Webworx Inc.. iTrade was defrauded of $11 million to finance non-existent computer contract services. Six Million dollars remained lost after the criminal proceedings were completed.

- As the aforementioned fraud was occurring, Mr. and Mrs. A. were conducting various personal investment transactions with BMO Nesbitt Burns in an investment account which, at the time of the judgment, held part of the proceeds of the fraud (the "Funds"), the entitlement to which was in issue before the Court. Mr. &Mrs. A. pledged the Funds as collateral for loans made to them as joint cardholders in a BMO Mastercard account. BMO accepted the pledge of the Funds as security for that account, and thereafter advanced the credit to Mr. & Mrs A. under the BMO Mastercard account. BMO had no knowledge of the fraud against iTrade or notice of the fact that the funds used to purchase the assets in the investment account were in fact proceeds of this massive fraudulent scheme.

- In setting up these investment arrangements, an agreement was signed appointing BMO Nesbitt Burns as agent for BMO to hold the pledged securities under a pledge agreement. That pledge agreement was never signed. BMO never registered any OPPSA interest in support of the pledge agreement that should have, but was not, in fact, signed.

- A little later, BMO recognized it had insufficient documentation in its account with Mr. A. and his wife, and obtained a "Notice and Direction" relating to the pledged investment account. This document stated, inter alia, that "BMO Nesbitt Burns shall retain possession and control over the property of the account for the benefit of BMO, and not as agent for the client".

- BMO admitted that it did not have a written security agreement from Mr. A. and his wife but it did have a security arrangement with them which was "partly written and partly oral".

- Following these arrangements, and following discovery of the iTrade fraud, judgment was rendered against Webworx and Mr. and Mrs. A. by the Court, which included a tracing order for funds. On execution of the tracing order it became apparent that the monies in the investment account, which in turn were pledged to BMO for the Mastercard debt, were subject to the tracing order. At that point, each of iTrade, pursuant to its tracing order, and BMO, pursuant to its "partly written and partly oral" security agreement, claimed entitlement to the Funds, being in the approximate amount of $140,000.

- On the motion, the lower Court held that iTrade was entitled to the money because BMO did not have a valid and fully written security interest in the shares in the investment account. Further, BMO was not a "bona fides purchaser for value", and therefore was not shielded from the effect of the tracing order obtained by iTrade. The motion judge then determined that iTrade was entitled to the Funds under the remedy of unjust enrichment, supported by the finding of a constructive trust by the lower court. This lower Court held that the pledge agreement between BMO and Mr. and Mrs. A. did not constitute a "juristic reason" for the enrichment of BMO/Webworx at the expense of iTrade.

- BMO appealed.

Issues

- Did BMO have a security interest that could be validly recognized under the OPPSA?

- If BMO held a security interest, was it a perfected security interest?

- If BMO holds a perfected security interest pursuant to its security agreement, does it have priority, and does that priority apply to the Funds?

Holdings of the Court

- The Court held that the BMO Nesbitt Burns agency arrangement, being partly written and partly oral, appointing BMO Nesbitt Burns as the agent for the bank in control of the Funds, constituted a valid security interest in favour of BMO over the Funds. This pledge to BMO gave it an interest as a "purchaser" of the shares/Funds (which includes the "taking by pledge" in s.1(1) of the OPPSA definitions). This interest was a "security interest" because it secured the payment or performance of an obligation, and that interest attached under the BMO Nesbitt Burns agency arrangement. The bank did give value and therefore created sufficient rights in the share collateral including their proceeds, the Funds, to create a security interest under s.11(2) of the OPPSA. Accordingly the Court held that the security interest was perfected by possession under s.22(1) of the OPPSA.

- Given that BMO was a perfected secured creditor in the Funds, the Court then examined the issue of whether or not s.4(1)[8] of the OPPSA excluded application of the OPPSA to the tracing order of the Court from the fraud proceedings. iTrade claimed a constructive trust in the funds, and it was a lien given priority by rule of law, therefore ranking ahead of the interests of BMO under the OPPSA.

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[8] "4. (1) Except as otherwise provided under this Act, this Act does not apply,(a) to a lien given by statute or rule of law, except as provided in subclause 20 (1) (a) (i) or section 31;"

- The Court held that, even though iTrade was an unwitting victim of a fraud, it did nevertheless issue shares to and in favour of Mr. & Mrs A. and Webworx. iTrade had the intention of transferring ownership in the shares and their proceeds as the Funds even where it was induced to do so by the fraud. This created a voidable title interest to the fraudsters in the Funds, and allowed them to create the security interest to and in favour of BMO/BMO Nesbitt Burns.

- The Court held that bona fides purchasers for value take without notice of the fraud. BMO Nesbitt Burns and BMO were recognized as having the legal status of "bona fides purchasers for value without notice".

- iTrade was held to have "behaved as if it intended to pass the property (in the shares and in the Funds) and must therefore accept the consequences of those actions". This meant that Mr. and Mrs. A. had sufficient property in the shares/Funds to create a security interest and to pledge them to BMO under its security. Once this occurred, iTrade's ability to trace funds pursuant to the tracing order was lost. The chain of tracing was broken where the funds found their way into the hands of a "third party purchaser for value without notice", with the result that iTrade lost its right to trace the Funds once they became charged under the BMO security arrangements.

- The Court then looked at whether or not the remedy of "unjust enrichment" saved the position of iTrade. To seek this remedy, iTrade would be required to convince the Court that the unjust enrichment was the result of a) enrichment of BMO, or b) a corresponding detriment to or deprivation suffered by iTrade, and c) the absence of any juristic reason for the benefit or enrichment.[9]

- The Court found that iTrade did suffer detriment, but was reluctant to find that BMO/BMO Nesbitt Burns had been "enriched" as the term is meant to be construed in the context of the unjust enrichment remedy analysis.

- BMO argued that it was not "enriched" because it had advanced loaned funds in good faith, and taken security interests for the same value in return, therefore there was no enrichment. The Court declined to make any finding on this point, but instead ruled that point to be irrelevant because the entire case could rise or fall on the basis of the final element for the unjust enrichment remedy, being the "juristic reason", analysis.

- The court held that there were valid juristic reasons for BMO to get the money. Those reasons included:

    (i) The existence of a valid contractual arrangement between Mr. & Mrs. A. and BMO;

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[9] The following cases were cited. *Rathwell v. Rathwell*, [1978] 2 S.C.R. 436; *Pettkus v. Becker*, [1980] 2 S.C.R. 834; *Peter v. Beblow*, [1993] 1 S.C.R. 980; re: *Attorney General of Canada v. Confederation Life Insurance Company* (1995), 24 O.R. (3rd) 717 (Gen. Div.).

(ii) The fact that, in law, Mr. & Mrs. A. and Webworx had sufficient property in the shares of the investment account to create a pledge; and

(iii) The Court's finding that BMO was a bona fides purchaser for value without notice of the fraud at the time of the lending transaction.

- The Court held that a valid contract leading to the creation of an arms length debtor/creditor relationship between the person enriched (BMO, if the Court had made a ruling on the point, but declined to do) and another (the Mr. & Mrs. A. and Webworx) is sufficient to establish the existence of a juristic reason for either an "enrichment" or "detriment" that can be accounted for on the basis of that contractual relationship. Here, the detriment suffered by iTrade was supported by such a finding.

Practical Significance for Lawyers

- There is not much more that iTrade could have done to protect its interests, other than taking security agreements against Mr. A. and his wife along with personal guarantees of the loan, and registered those under OPPSA.

- From the BMO perspective, it behooves a secured lender to obtain fully executed security agreements at all times, and then to register those security agreements, out of an abundance of caution. However, the lack of completeness of a paper trail to and in favour of BMO did not hurt it in this case.

CASE: GE Canada Equipment Financing G.P. v. ING Insurance Co. of Canada ("ING") (Ont. C.A.)

Brief Summary of Facts

- Lender (GE) financed two tractor trailers for a rental company ("R"), title retention clauses were included in the security agreements.
- GE registered security interests under OPPSA.
- R in turn leased the vehicles to customers (collectively, "C") who then obtained insurance on them from ING.
- GE was not named in the insurance policies as loss payee.
- C and ING did not know about the interests of GE at the time of underwriting of the insurance policies.
- The vehicles were stolen.
- R submitted proofs of loss to ING that specifically stated that no other persons had an interest in the lost property.
- ING paid the loss, as per the proofs, less deductibles of C.
- Title in the vehicles was transferred by C to ING following payment of loss.
- Vehicles are then found, ING sells one of them retaining the proceeds against loss claims paid.
- GE brought the application for declaration of priority of its security interests over the interests of ING.

Issues

- What is the interaction between s. 4(1)(c) OPPSA vs s. 258(3) and Statutory Condition 6(7) of the Insurance Act (Ontario)?
- Was GE entitled to return of its vehicles, or the proceeds of sale thereof?

Holdings of the Lower Court (Ontario Superior Court of Justice per Lederman J)

- The lower court ruled that the Insurance Act negates the effect of perfected interests under the OPPSA.
- Salvage vests in ING, therefore ING was entitled to the remaining vehicle and the proceeds of sale on the sold vehicle.

Holdings on Appeal

- Court declared the GE's PMSIs and the trucks and their proceeds have priority over ING's salvage rights in the same vehicles, and further that GE is entitled to possession of the 2003 truck and to the proceeds from the sale of the 2005 truck.

- GE's PMSIs and the trucks were perfected by registration under the OPPSA before the issuance of the ING policies and the transfer. s.9(1)[10] of the OPPSA established the GE's PMSIs had priority over the interests of all third parties with a subsequently acquired interest in the secured collateral. s.4(1)(c) of the OPPSA did not relieve ING of the requirement to be mindful of the OPPSA protected interests of the secured creditors.

- ING was given title in the salvage subject to the security interests of GE, with the result that GE's perfected PMSIs security interest took precedence over the entitlement of ING to the salvage.

Practical Significance for Lawyers

- Insurers must now be in a position to conduct OPPSA searches over vehicles that they insure if they intend to maintain their statutory right in salvage under the *Insurance Act* (Ontario) and its' statutory conditions, at inception of the policy, payment of the total loss, or upon realization of salvage rights.

[10] **"9.** (1) Except as otherwise provided by this or any other Act, a security agreement is effective according to its terms between the parties to it and against third parties. R.S.O. 1990, c. P.10, s. 9 (1)."

CASE: Magna International Inc. v. Formulated Coatings Ltd., Court File No. 09-CL-7967

Brief Summary of Facts

- This is a dispute between a Receiver and GMAC over priority in a vehicle.
- Incorrect debtor name, "Lt" vs "Ltd."
- Correct VIN registration.

Issues

- Should the Receiver give the car back to GMAC who held a first charge on the basis of an incorrect debtor name filing?
- Can GMAC rely on Re: Lambert?[11]
- Do the curative provisions of s.46(4) of the OPPSA apply?

Holdings of the Court

- The Court held that notwithstanding academic arguments to the contrary, the reasonable person test under s.46(4) of the OPPSA is determined by the Re: Lambert case. Lambert determined that a reasonable person would conduct both a specific debtor name search and a VIN search, thereby not being misled by an error in the debtor name.
- The Ontario position in Lambert is contradicted by the Courts in Saskatchewan, Alberta and New Brunswick, and is subject to considerable academic criticism on the point, but this was not relevant.
- The Court held that it was nevertheless bound by Lambert and could not amend the fact that the curative provisions applied, with a result that the Receiver was compelled to return the car to GMAC as the first priority secured creditor pursuant to the curative provisions of the OPPSA.

Practical Significance for Lawyers

- In registering against vehicles, debtor name searches and complete VIN's must always be obtained and double checked in the filings.
- Courts will endorse certainty in business transactions.

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[11] 7 OPPSA C (2nd) 240, 1995 KCAN LII 3500 (Ont. C.A.)

CASE: GMAC v. Alex Williamson Motor Sales, Court File No. CV-09-379796

Brief Summary of Facts

- Transaction for sale of a vehicle from one GMAC dealer to another under circumstances in which the security interests of the lender to the purchaser dealer, GMAC, were not repaid.

- Seller dealer of the vehicle attempted to repossess the vehicle, there being some dispute about the consent for that repossession. The seller dealer did not have a security agreement over the vehicle.

- Immediately prior to the attempted repossession of the vehicle by the seller dealer, the purchaser dealer went bankrupt and then failed to honour its uncertified cheque which was to constitute payment for its' purchase of the vehicle.

Issues

- Who wins in a contest between two innocent parties, being the lender for the purchaser (GMAC), and the seller dealer of the vehicle?

Holdings of the Court

- Seller dealer had no security interest in the vehicle, but did fully transfer title in the vehicle to the purchaser dealer.

- GMAC held a security interest in the vehicle at the moment of sale and transfer of title to the purchaser dealer.

- The Court held that the lack of a security agreement by the seller dealer was fatal to the priority battle it had against GMAC. The GMAC security agreement was good and valid, and this mitigated against retention of the vehicle by the seller dealer.

Practical Significance for Lawyers

- Seller dealer should have taken a certified cheque, bank draft or letter of credit for the full purchase price, and should have accepted nothing less.

Conclusion

The cases reviewed in this paper confirm that the OPPSA is not a complete and self sustaining code. Jurisprudence continues to resolve gaps in this statute, and to bring the practices in line with business realities and objectives. The Courts have continued to show their propensity to favour certainty and structure in resolving priority disputes. This sometimes comes at a cost with respect to the reasonable commercial expectations of the individual parties. Courts will strive, wherever possible, to satisfy the expectations of parties who have chosen to act within the framework of the OPPSA to achieve the goals of disclosure and certainty in business dealings. Where those expectations cannot be met, the overall integrity and fairness of the OPPSA system seem to be paramount in establishing the outcomes.