1. Introduction

I have been a member of the Ontario Bar Association’s Personal Property Security Law Committee (“PPSL Committee”) for the past 15 years. The committee comprises about twenty members, most of them legal practitioners specializing in secured lending or banking and finance law. The committee also includes two in-house bank lawyers, a representative of the motor vehicle industry, a provincial government representative and two law professors. The committee’s main function is to make recommendations for reform of the Ontario Personal Property Security Act, having regard, in particular, to new commercial developments, statutory developments in the other provinces, the United States and elsewhere and developments in the case law. The committee has achieved moderate success in persuading the government to adopt its recommendations. The most recent substantial round of PPSA amendments was in 2006, and most of these reforms resulted from recommendations made by the committee.

However, the pace of PPS law reform in Ontario has slowed in recent years, in part because for some of this time there has been a minority government in power and the politics of staying in office have affected government priorities. The PPSL Committee has remained active during this period and has continued to make submissions to the government. None of the committee’s more recent submissions has been acted on as yet, but they are all still on the table and the committee continues to press for their implementation.

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In this paper, I discuss three of the PPSL Committee’s more recent projects, the first dealing with security interests in statutory and contractual licences, the second with security interests in cash collateral and the third, which is just getting under way, with security interests in proceeds collateral. I have chosen these topics because they involve interesting and important policy questions and so they are more likely to engage an international audience than other, more technical, topics I might have chosen instead.

2. Security interests in statutory and contractual licences

(a) Statutory licences

A question that has been much litigated in Ontario is whether a statutory licence qualifies as personal property for the purposes of the statute. Example 1, below, illustrates the context in which the issue typically arises.

Example 1. Debtor runs a commercial fishing business and he holds a fishing licence from the relevant government authority. SP makes a loan to Debtor and takes a security interest in all Debtor’s present and after-acquired personal property. Debtor ends up in financial difficulty and SP appoints a receiver. The receiver is keen to sell Debtor’s business on a going-concern basis because this will bring in a higher return than the piecemeal sale of Debtor’s assets. But the business is worthless without the licence.

Whether the receiver can transfer the licence as part of the sale depends on whether SP’s security interest extends to the licence. This question, in turn, depends on whether the licence is “personal property” within the meaning of the security agreement and the statute. OPPSA, section 1(1) defines “personal property” to mean:

“chattel paper, documents of title, goods, instruments, intangibles, money and investment property”.

Each of these expressions is in turn defined. A statutory licence does not fit the definition of chattel paper, documents of title, goods, instruments, money or investment property. But it may fall under the catch-all definition of “intangible”, which reads as follows:
“Intangible” means all personal property, including choses in action, that is not goods, chattel paper, documents of title, instruments, money or investment property”.

The question, therefore, is whether a statutory licence qualifies as personal property. There is a line of Ontario cases suggesting that the answer is, “no”, or at least “arguably not”. The cases identify three related concerns:

- the licensing statute will typically give the licensing authority discretion to suspend or cancel a licence or to refuse to renew it. How can a licence qualify as property if the licensing authority has a discretion to take it away?
- The licensing statute may prohibit transfers or it may give the licensing authority a discretion to refuse a transfer. How can a licence qualify as property if it is not freely transferable?
- As a matter of public policy, the licensing authority needs to have control over who holds a licence. That control might be undermined if the courts allowed security interests in the licence.

The issue came before the Supreme Court of Canada in *Saulnier v. RBC*, where the facts resembled Example 1, above. The court rejected the earlier cases law and concluded that a fishing licence was “personal property”, at least for the purposes of the PPSA and the bankruptcy laws. The judgment was written by Binnie J.

As Binnie J. explained, there are two main policy considerations underlying the treatment of statutory licences as personal property. The first is the importance of facilitating access to credit in cases like Example 1, above. The second is the need to maintain the integrity of the licensing scheme. He expressed the first consideration as follows:

A commercial fisher with a ramshackle boat and a licence to fish is much better off financially than a fisher with a great boat tied up at the wharf and no licence. Financial institutions looking for readily marketable loan collateral want to snap up licences issued under the federal Regulations, which in the case of the lobster fishery can have a dockside value that fluctuates up to a half million dollars or more. Fishers want to offer...
as much collateral as they can to obtain the loans needed to acquire the equipment to enable them to put to sea.

Binnie J. expressed the second consideration as follows:

“Canada’s fisheries are a ‘common property resource belonging to all the people of Canada. Under the Fisheries Act, it is the Minister’s duty to manage, conserve and develop the fishery on behalf of Canadians in the public interest… Licensing is a tool in the arsenal of powers available to the Minister under the Fisheries Act to manage fisheries”.

By implication, the cost of treating a fishing licence as personal property lies in the danger of fettering the Minister’s discretion.

However, as Binnie J. goes on to point out, there is no such danger. The reason is that the PPSA gives the secured party no greater rights than the debtor himself had (nemo dat quod non habet). The debtor holds the licence subject to the Minister’s discretion as provided by the licensing statute and, likewise, the debtor’s right to transfer the licence is subject to the Minister’s discretion. Therefore, the secured party’s rights to hold and transfer the licence are also at the Minister’s discretion:

“It may well be that in the course of a [receivership] the fishing licence will expire, or has already expired. If so, the [receiver] will have the same right as the original holder of an expired licence to go to the Minister to seek its replacement, and has the same recourse (or the lack of it) if the request is rejected. The debtor can transfer no greater rights than he possesses. The [receiver] simply steps into the shoes of the debtor and takes the licence ‘warts and all’”.

To summarize, Binnie J.’s “warts and all” principle has two implications:

(1) a security interest in a statutory licence does not interfere with the licensing authority’s discretion and so there is no threat to public policy; and

(2) when a secured party is negotiating for a security interest in a licence, it must take account of the risk that the licensing authority might exercise its discretion contrary to the secured party’s interests, for example, by blocking a proposed future sale of the licence, or by

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5 [2008] 3 SCR 166 at para. [14], quoting Comeau’s Seafoods Ltd v. Canada (Minister of Fisheries and Oceans) [1997] 1 SCR 12 at para.[37].SCC
6 [2008] 3 SCR 166 at para.50].
cancelling or refusing to renew the licence. On all these fronts, the secured party is as vulnerable as the debtor/licence-holder and it must make a commercial decision about whether to assume the risk.

Ultimately, however, Binnie J. did not rest his decision on these broad policy grounds. Instead, he reasoned that a fishing licence is at least analogous to a *profit a prendre* and that, given the *profit a prendre* is a well-established property right, fishing licences should also be treated as property. The difficulty with this line of reasoning is that not all statutory licences are like *profits a prendre*. For example, the analogy between a taxi licence and a *profit a prendre* would be harder to draw and the same point could be made about nursing home licences and milk or tobacco quotas. On the other hand, these licences, like a fishing licence, may represent major commercial assets. In summary, it is unclear, in the wake of *Saulnier*, whether licences which do not exhibit *profit a prendre* characteristics would qualify as personal property for PPSA purposes. The policy considerations Binnie J. advances in the first part of his judgment suggests that they should, but the second part of his judgment suggests otherwise.

(b) Contractual licences

A contractual licence is a form of agreement under which licensor A gives licensee B permission to use A’s property. Licensing is a common method for the sharing of intellectual property rights (patents, copyrights, trademarks, and the like). In form, a contractual licence is a promise by A to B that B may use A's property for the duration of the agreement. The licence may contain a provision prohibiting B from assigning its rights or, alternatively, stipulating that B may not assign its rights without A’s consent. Can B use the licence as collateral? As in the case of a statutory licence, the answer depends on whether a contractual licence is “personal property” within the meaning of the PPSA.

*Saulnier* was concerned with statutory licences, but the case has implications for contractual licences as well. In *Saulnier*, Binnie J. remarked that “a simple licence [probably could not] itself be considered property at common law”. But he went on to say that “if not property in the

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7 For similar reasoning, but in a different context, see *Harper v. Minister for Sea Fisheries* (1989) 168 CLR 314 (HCA).
8 These examples are all taken from the Ontario cases referred to above.
common law, a fishing licence is unquestionably a major commercial asset". The same is true of a contractual licence such as an intellectual property licence and, applying the first part of Binnie J.’s judgment, this should lead to the conclusion that the licence is personal property in the PPSA context. Therefore, the licence may be used as collateral, but subject to the “warts and all” limitation. In other words, if the licence agreement provides that the licensee may not transfer its entitlement without the licensor’s consent, the secured party would be subject to the same limitation and therefore, if it wanted to enforce its security interest by selling the licence, it would first have to seek the licensor’s approval. On the other hand, if the licence agreement absolutely prohibited transfer of the licence, the secured party would obtain no rights in the licence at all unless, perhaps, it was able to negotiate with the licensor for a waiver of the prohibition.

However, as indicated above, *Saulnier* is ambiguous and, on a narrower reading of the case, a licence is not personal property unless it is analogous to *a profit a prendre* or, at least, is part of a bundle of rights which includes a recognized proprietary entitlement. A contractual licence typically will not satisfy this requirement and therefore it is not personal property, even if there is no anti-assignment provision in the licence agreement.

(c) *Statutory reforms*

Saskatchewan is the only province to have expressly addressed the licence issue. Section 2(w) of the Saskatchewan PPSA defines “intangible” to include a licence and section 2(z) defines “licence” to mean:

“a right, whether or not exclusive:

(i) to manufacture, produce, sell, transport, or otherwise deal with personal property; or

(ii) to provide services;

that is transferable by the grantee with or without restriction or the consent of the grantor.”

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9 [2008] 33 SCR 166 at para.[23].
10 But the North West Territories PPSA follows the Saskatchewan lead.
The provision applies to both statutory and contractual licences. A statutory licence falls outside the definition unless it is transferable. It follows that, if the governing statute absolutely prohibits transfers, the licence is not personal property to which the PPSA applies.\(^\text{12}\) On the other hand, the fact that transfer of the licence is at the licensing authority’s discretion does not take the licence outside the PPSA definition. Likewise, a contractual licence falls outside the definition if the licence agreement prohibits assignment. On the other hand, if there are no restrictions on assignment, or if assignment is permitted subject to restrictions, the licence is personal property and it may be used as collateral. Enforcement of the security interest will typically involve sale of the licence to a willing buyer, along with the business to which the licence relates. In this connection, Saskatchewan PPSA, section 57(3) provides that the secured party may seize the licence upon giving notice to the debtor and also to the grantor of the licence, while section 59(18) provides that the licence may be disposed of only in accordance with the terms and conditions under which the licence was granted. These provisions reflect the “warts and all” principle.

In 1998, in a submission which pre-dated *Saulnier*, the PPSL Committee, through the Canadian Bar Association – Ontario, recommended amendments to the OPPSA along the lines of the Saskatchewan model.\(^\text{13}\) As Binnie J. was later to do in *Saulnier*, the submission stressed that the proposal constituted no threat to the licence grantor’s interests because the secured party takes its security interest “warts and all”:

“Whatever restrictions exist in the terms of the license or in the relevant legislation imposing regulatory requirements will continue to apply. The explicit inclusion of licenses simply means that the OPPSA applies to a security interest in a license. It leaves it up to the secured party, as a matter of commercial judgment, to decide whether the license is suitable collateral having regard to the contractual or statutory restrictions in the license.”\(^\text{14}\)

The proposal was not adopted, apparently because some government stakeholders, including the Ministry of Agriculture, Food and Rural Affairs, took the view that Ministries responsible for the

\(^\text{12}\) Compare Revised Article 9, Uniform Commercial Code- Secured Transactions s.9-401(a), which is to similar effect.

\(^\text{13}\) Canadian Bar Association – Ontario, *Submission to the Minister of Consumer and Commercial Relations Concerning the Personal Property Security Act* (1 October, 1998).

issue of government licences and quotas should have exclusive responsibility for the transfer, assignment and creation of interests in them. This concern seemingly overlooks the warts and all qualification. In any event, the same proposal was put to the government again in 2006 and, again, it was rejected. It appears that, at the political level, the warts and all idea is a hard one to get across.

The committee submitted a new draft proposal in 2009 with the aim of removing the uncertainty left by the Saulnier decision. In common with the earlier proposals, the 2009 version allows for security interests in a licence unless the governing statute prohibits the transfer of licences. However, in contrast to the Saskatchewan approach, the effect of a prohibition on licence transfers would be simply to prevent the secured party from enforcing its security interest by selling the licence and not to prevent the creation of the security interest in the first place. The thinking is that the licence itself may be viable collateral even if it is non-transferable because, for example, it may allow the secured party’s receiver to operate the business. On the other hand, the proposed reform envisages that the licence statute might prevent the creation of security interests altogether by expressly providing that security interests are prohibited. The 2009 proposal is still on the table. The chances of its being adopted are uncertain but the fate of the earlier proposals does not provide much ground for optimism. Given the political challenges of selling the case for statutory reform, Saulnier’s failure to unambiguously resolve the matter assumes added significance.

3. Security interests in cash collateral

Cash deposits are commonly used as collateral. For example, a bank may open a line of credit in its customer’s favour on the basis that the customer or a related party deposits an agreed sum of money with the bank and gives the bank a security interest in the deposit to secure repayment of amounts outstanding from time to time under the line of credit. But the use of cash collateral is

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also widespread outside the context of bank lending. For example, a utility company might require a customer to deposit a sum of money as security for the customer’s obligations to pay its bills. Cash collateral may also be used to secure a party’s obligations under a derivatives contract or a securities lending transaction.

Revised Article 9 of the United States Uniform Commercial Code does not allow for perfection by registration of a security interest in a deposit account.\textsuperscript{17} However, a secured party may perfect a security interest in a deposit account by taking control of the account.\textsuperscript{18} In the case of a security interest taken by a secured party other than the deposit-taking institution itself (the bank), the secured party may obtain control either by becoming the bank’s customer in respect of the deposit (account) or, alternatively, by entering into a control agreement under which the bank agrees to comply with the secured party’s instructions directing disposition of the funds without the debtor’s further consent. In the case of a security interest in the account taken by the bank itself, the security interest is automatically perfected by control; in other words, the bank obtains control simply by virtue of being the deposit-taking institution.\textsuperscript{19} Revised Article 9, section 9-327(1) provides that a security interest perfected by control has priority over a conflicting security interest held by a secured party that does not have control.\textsuperscript{20} This rule applies even if the conflicting security interest is perfected by some other method and regardless of the order in which the conflicting security interests became perfected. Examples 2 and 3, below illustrate the application of these rules.

\textbf{Example 2.} On Date 1, SP1 takes a security interest in all Debtor’s present and after-acquired personal property and registers a financing statement. On Date 2, SP2 provides

\textsuperscript{150} There is no Canadian authority directly on point but the \textit{Drummond} case proceeds on the assumption that charge-backs are permissible.

\textsuperscript{17} United States Uniform Commercial Code – Secured Transactions, s.9-312(b)(1). Section 9-312(b) does not apply where a secured party holds a security interest in the deposit account as proceeds and, s.9-315(c) applies instead. Section 9-315(c) provides that a security interest in proceeds is a perfected security interest if the security interest in the original collateral was perfected. For example: SP holds a security interest in Debtor’s inventory perfected by registration. Debtor sells inventory in the ordinary course of business and deposits the sale proceeds. SP’s security interest extends to the deposit as proceeds of its original collateral and, applying s.9-315(c), the security interest, as it applies to the deposit, is perfected by registration.

\textsuperscript{18} Ibid., s. 9-314.

\textsuperscript{19} Ibid., s.9-104.

\textsuperscript{20} As a general rule, security interests perfected by control rank according to priority of time in obtaining control: s.9-327(2). However, subject to s.9-327(4), a security interest held by the bank with which the deposit account is maintained has priority over a conflicting security interest held by another secured party: s.9-327(3); and a security interest held by the bank with which the deposit account is maintained is subordinate to a security interest where the secured party has obtained control by becoming the bank’s customer with respect to the account: s.9-327(4).
credit to Debtor on the security of a cash deposit and obtains control over the deposit on the same date. On Date 3, Debtor defaults against SP1 and SP2 and they both claim the deposit.

SP2 may be either the deposit-taking institution itself or a third party. This variable may affect the steps SP2 must take to obtain control on Date 2, but it does not affect the final outcome. Applying Revised Article 9, section 9-312(b)(1), SP1’s registration does not perfect its security interest in the deposit account and, since SP2’s security interest is perfected by control, SP2 has priority over SP1. SP1 could have avoided this result by itself taking control of the account on Date 1 and parties in SP1’s position can be expected to take this step if the account “is an integral part of their credit decision”.\(^\text{21}\) The official explanation for the rule, in its application to banks, is that it “enables banks to extend credit to their depositors without the need to examine either the public record or their own records to determine whether another party might have a security interest in the deposit account.”\(^\text{22}\) In other words, the purpose is to facilitate bank lending. The purpose of the rule in its other applications is to facilitate transactions which depend on cash collateral, for example derivatives trading and securities lending. It does this by avoiding the need for parties to register and search in advance of the transaction and by enabling the party taking security to be sure of its priority position before committing itself to the transaction.

In Example 2, SP1 claimed the disputed account as part of its original collateral. But the result will be the same in cases where the claim is to the disputed account as proceeds, as in Example 3.

**Example 3.** On Date 1, SP supplies Debtor with inventory on conditional sale terms and registers a financing statement. Debtor maintains an operating account with Bank. On Date 2, Bank opens a line of credit in Debtor’s favour and takes a security interest in the account to secure repayment. On Date 3, Debtor having sold SP’s inventory for cash, deposits the proceeds into the account. On Date 4, Debtor defaults against both SP and

\(^{21}\) Official Comment on Revised Article 9, s.9-327, para.3. To obtain priority over Bank, SP would need to obtain control of the account by becoming Bank’s customer with respect the account, i.e., the account would have to be transferred into SP’s name. The alternative way of obtaining control would be for SP to enter into a control agreement with Bank and Debtor, but this form of control will not give SP priority over Bank: see Revised Article 9, ss 9-104 (a)(3) and 9-327(3) and (4) and see footnote 19, above.

\(^{22}\) Official Comment on Revised Article 9, s.9-327, para.4.
Bank. SP claims the Date 3 deposit as proceeds of the inventory while Bank claims the deposit as part of its original collateral.

Since SP is claiming the deposit as proceeds of its original collateral, Revised Article 9, section 315(c) displaces section 9-312(b)(1) with the result that SP’s Date 1 registration perfects its security interest in the deposit account.23 However, Bank’s security interest was automatically perfected by control and so, applying Revised Article 9, section 9-327(1), Bank has priority over SP, even though Bank was later on the scene. According to the Official Comment, SP could avoid this outcome by requiring Debtor to deposit all inventory sale proceeds into a segregated account. But this precaution will not protect SP if Debtor breaches the agreement and pays the proceeds into the disputed account instead.24

The Canadian PPSAs currently make no provision for perfection by control of a security interest in a deposit account. A security interest in a deposit account may be perfected by registration and the ordinary first in time priority rule applies. The result is that in cases like Example 2, above, SP2 cannot obtain priority over SP1 except by negotiating a subordination agreement. The same is true in cases like Example 3 and, given the special priority rules for purchase-money security interests, it would still be true even if Bank had taken and perfected its security interest ahead of SP. Until recently, it was thought that banks and other deposit-taking institutions could avoid these outcomes by relying on the law of set-off as an alternative to claiming a security interest.25 Banks have the right at common law to combine accounts, which is equivalent to a right of set-off. But a bank will not always be content to rely on the right of combination and it may insist on an express right of set-off in its agreement with the customer. The agreement may also include a promise by the customer to maintain (not to withdraw) the deposit so long as any amount is still owing to the bank under the loan agreement. This is commonly referred to as a “flawed asset arrangement”.

The bank’s agreement with its customer may give the bank set-off rights in combination with a flawed asset arrangement and it may also, for good measure, give the bank a security interest in

23 See footnote 16, above.
24 Official Comment on Revised Article 9, s.9-327, para.4.
25 See, e.g., OPPSA, s.40(1.1), dealing with the competing claims of the assignee of an account (including a secured party holding a security interest in the account) and a party with set-off rights in the account. This provision effectively codifies the common law rules governing the exercise of set-off rights against the assignee of an account.
the relevant deposit account. This type of transaction is commonly referred to as a “triple cocktail”. Historically, the law of set-off was distinct from the law of secured transactions and the conventional wisdom was that the triple cocktail allowed the bank to pick and choose its remedies depending on the circumstances. In particular, in a case like Example 3, a triple cocktail arrangement would allow Bank to avoid the application of the PPSA by relying on the first two ingredients of the arrangement rather than the third and Bank’s right of set-off would defeat SP unless SP had previously notified Bank of its security interest.26 A right of set-off or combination combined with a flawed asset arrangement is functionally indistinguishable from a security interest in a deposit account; in both cases, the bank enforces its claim by helping itself to payment out of the deposit account. It follows that the difference between the various ingredients of the triple cocktail is a purely formal one and in a legal regime which elevates substance over form the distinction collapses.

The Supreme Court of Canada upturned the apple cart in the Drummond case by recognizing the substantial equivalence of a contractual right of set-off exercisable against a flawed asset and a security interest. The case involved a line of credit transaction between a credit union and its customer supported by a triple cocktail arrangement. The relevant terms were that: (1) the customer would deposit an agreed sum with the credit union; (2) the customer would maintain the deposit for a 5 year term; and (3) the credit union could set off against the deposit any amount outstanding under the line of credit from time to time. The case was litigated in Quebec and the issue arose in the context of the federal Income Tax Act.27 Nevertheless, the decision has clear implications for the other provinces in the PPSA context because the PPSAs apply to “every transaction without regard to its form … that in substance creates a security interest”.28 On this basis, in a case like Example 3, assuming Bank’s Date 2 agreement with Debtor involved

26 See Derham on the Law of Set-Off (4th ed., OUP, Oxford, 2010), para.17.34 (legal and equitable set-off), 17.54 - 17.57 (contractual set-off - set-off agreement preceding assignment); 17.59 (contractual set-off - set-off agreement following assignment). In Example 3, the date before which SP must give notice is probably Date 2 (the date the line of credit is opened), but possibly Date 4 (the date Bank claims set-off).
27 RSC 1985, c.1. Section 227(4.1) of the ITA creates a deemed trust in favour of the Crown over property of an employer that has deducted income tax at source. The deemed trust secures the employer’s obligation to remit the deductions to the government. The deemed trust is expressed to have priority over any competing security interest. “Security interest” is defined in s.224(1.3) to mean: “any interest in property that secures payment or performance of an obligation and includes an interest created by or arising out of a debenture, mortgage, hypothec, lien, pledge, charge, deemed or actual trust, assignment or encumbrance of any kind whatever, however or whenever arising, created, deemed to arise or otherwise provided for”. This provision is similar to the PPSA substance over form definition of security interest; hence the relevance of the Drummond case in the PPSA context.
28 See, e.g., Ontario PPSA, s.2.
a triple cocktail arrangement, it would make no difference whether Bank relied on its right of set-off or its security interest: either way, the PPSA applies and Bank’s claim is subordinate to SP’s prior perfected security interest in the account.

Partly in response to the Drummond case, the PPSL Committee, through the Ontario Bar Association, made a submission to the provincial government in February 2012 recommending new PPSA cash collateral provisions based on the Revised Article 9 approach discussed above. The government responded quickly with an announcement in its 2012 budget that it planned amending the PPSA “to make it easier for business and financial institutions to provide or obtain a first-priority security interest in cash collateral”. But the proposal subsequently encountered opposition on the ground that, in cases like Example 3 above, it would unfairly advantage banks and other deposit-taking institutions at the expense of inventory suppliers and accounts receivable financiers. In response to this concern, the government established an Expert Working Group (EWG) to provide further advice. An EWG sub-committee was set up with the task of developing a compromise proposal, in other words to identify a set of reforms that would facilitate the taking of security interests in cash collateral by deposit-taking institutions and others, while at the same time providing a measure of protection for inventory suppliers and accounts receivables financiers against loss of their proceeds claims. As a result of this process, there is now a compromise proposal on the table but, at the time of writing, details had still not been made public and the government had not announced its intentions.

4. Security interests in proceeds

(a) The secured party’s cumulative entitlements

Pre-PPSA, if the debtor sold or otherwise dealt with the collateral, the secured party had the choice of either enforcing its security interest against the original collateral in the transferee’s hands or enforcing its security interest against the sale proceeds in the debtor’s hands. But it could not claim both the original collateral and the proceeds because the remedies are

29 Ontario Bar Association, Perfecting Security Interests in Cash Collateral (submission to the Ontario Ministry of Consumer Services and Ministry of Finance, 6 February 2012).
inconsistent. The secured party’s claim to the proceeds rested on its implied adoption of the sale, whereas its claim to the original collateral presupposed rejection of the sale.31

The position is different under the PPSAs. OPPSA, section 25(1) provides as follows:

Where collateral gives rise to proceeds, the security interest therein,

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

(b) extends to the proceeds.

The corresponding provision in the other provincial PPSAs goes on to say:

But where the secured party enforces a security interest against both the original collateral and the proceeds, the amount secured by the security interest in the collateral and the proceeds is limited to the market value of the collateral at the date of the dealing.32

It is clear from the wording of OPPSA, section 25(1) and the corresponding provision in the other provinces that under the PPSA, the secured party’s rights are cumulative. The change from pre-PPSA law was deliberate and the purpose was “to protect the secured party from deteriorations in value that occur after the dealing. Some of the proceeds may have been spent or otherwise lost, and the original collateral may have fallen in value through depreciation”.33

As indicated above, the non-Ontario PPSAs provide that if the secured party enforces its security interest against both the original collateral and proceeds, it can recover no more than the market value of the collateral at the date of the dealing. The purpose of the limitation is to prevent the secured party from obtaining a windfall as a result of the dealing. Example 4, below illustrates the point.

32 See, e.g., Personal Property Security Act 1993, S.S. 1993, c.P-6.2 (“Saskatchewan PPSA”), s.28(1)
Example 4. SP holds a security interest in Debtor’s printing press, perfected by registration. The security interest secures a $5,000 loan to Debtor. On Date 1, Debtor sells the printing press to Buyer without SP’s consent. The market value of the printing press is $2,700, but the parties agree on a price of $1,000. On Date 2, Debtor deposits the $1,000 in her bank account. There are no other funds in the account. On Date 3, SP learns about the sale and takes steps to enforce its security interest.

Assuming, for example that Saskatchewan law applies, SP can enforce its security interest against both the printing press in Buyer’s hands and the $1,000 sale proceeds, but for no more than $2,700, which was the value of the printing press on Date 1. If there were no restriction on SP’s cumulative claims, its collateral value would be $3,700 (representing the $2,700 value of the printing press and the $1,000 bank deposit), whereas if Debtor had not sold the printing press in the first place, SP’s collateral value would have been only $2,700 or perhaps less if the value of the printing press had depreciated since Date 1. There is no reason in principle why SP should profit as a result of Debtor’s actions.34

There is no express limitation in the Ontario PPSA on the secured party’s cumulative entitlements under section 25(1), but in Bank of Nova Scotia v. IPS Invoice Payment System Corporations,35 the court held that the limitation was implicit. The court’s interpretation of section 25(1) was a creative one, but it can be justified having regard to the policy considerations outlined above. The PPSL Committee is currently considering whether to recommend codifying this aspect of the IPS case by enacting a statutory version of the limitation along the lines of the approach the other provinces have taken.

(b) Enforcing a security interest

Example 5, below, is a simplified version of the facts in the IPS case.

Example 5. On Date 1, Bank opens a line of credit in Debtor’s favour and takes a security interest in Debtor’s present and after-acquired inventory and accounts to secure repayment. Bank registers a financing statement on the same day. Debtor draws $500,000 on the line of credit. On Date 2, Debtor enters into a factoring agreement assigning a

34 Ibid.
block of accounts to Factor. The face value of the accounts is $275,000 and the agreed price is $200,000. Factor pays Debtor and Debtor pays the money into his line of credit account with Bank. Bank is unaware of the factoring agreement and is also unaware of where Debtor’s $200,000 deposit came from. On Date 3, Factor collects on the accounts, recovering a total of $225,000; Factor pays this money into a bank account where it remains traceable. On Date 4, Bank finds out about the Date 2 and Date 3 events and takes steps to enforce its security interest, claiming the $225,000 Factor has collected.

As indicated above, all the Canadian PPSAs permit a secured party to enforce its security interest against both the original collateral and proceeds that have been generated by a dealing in the collateral. In provinces other than Ontario, there is a statutory limitation on the secured party’s cumulative entitlements, while in Ontario, it has now been established that OPPSA, section 25(1) is, by implication, subject to the same limitation. The limitation applies “where the secured party enforces [its] security interest against both the original collateral and the proceeds”. In the IPS case, the factor’s payment to the debtor was proceeds of the bank’s original collateral (the accounts) and the court treated the bank as having enforced its security interest against these proceeds when the debtor used them to pay down its line of credit with the bank. In other words, the court read the statutory limitation as covering not only the case where the debtor is in default and the secured party recovers payment by enforcing its security interest, but also the case where the debtor is not in default and makes a voluntary payment to the secured party in reduction of the debt. Applying this reasoning to the facts of Example 5, Bank’s claim against Factor is limited to $75,000. The court gave no reasons in support of this construction and it appears simply to have assumed that the limitation applied in both cases.

However, the issue was directly addressed in *Toronto-Dominion Bank v. Kerwin Capital Corp.* In that case, the bank argued that the statutory limitation “is not intended to cover ‘voluntary’ payments” and it only applies “when the proceeds are ‘captured’ by the [secured party] and applied to the indebtedness of the parties through enforcement on default”. The court rejected the argument on both statutory interpretation and policy grounds. It held that the statutory limitation “does not make [the distinction contended for by the bank], and if it was pivotal for the

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36 2013 SKQB 376.
37 *Ibid.* at para.[43].
operation of the section, then one would expect it to be set out in the PPSA”. The court also held that the exclusion of voluntary payments from the statutory limitation would place “an undue burden on third parties”. “A third party should not risk losing its interest simply because a payment is made by a debtor to its secured creditor when the secured creditor is not enforcing the debt”.

The decision in Kerwin is open to question as a matter of statutory interpretation. The word “enforcement” is typically used when the debtor is in default under the security agreement and the secured party asserts its rights over the collateral. There is nothing in the statute to indicate that the legislators intended a different meaning. On the contrary, the legislative history of the provision clearly indicates that it was intended to operate only where the secured party is enforcing its security interest upon default.

The court’s policy argument in Kerwin is also open to criticism. Wood states the argument more fully as follows:

“Suppose that the secured debt is $100 and the collateral is worth $50. The debtor then sells the collateral to a buyer for $50. Why should it matter if the secured party simply receives the $50 from the debtor by way of a voluntary payment rather than taking enforcement action against the $50 while it is still in the debtor’s hands? To permit the secured party to enforce against the collateral permits it to move from a partly secured to a fully secured status. Should the secured party have its cake and eat it too?”

But Wood goes on to state the counter-argument:

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38 Ibid. at para.[48].  
39 Ibid. at para.[50].  
40 Ibid. at para. [51]. These comments were strictly obiter because the court found that the bank had authorized the dealing with the collateral free of the security interest and therefore its security interest did not continue in the original collateral: Saskatchewan PPSA, s.28(1)(a). Furthermore, the court appears to have overlooked the point that the bank’s security interest was in all the debtor’s present and after-acquired personal property and, therefore, the money the factor, Kerwin paid the debtor pursuant to the factoring agreement was original collateral, not proceeds.  
41 Wood, op.cit. at 365.  
43 Wood, op.cit. at 364.  
44 Ibid. at 364-365.
“Suppose that a secured party takes a security interest in collateral to secure an operating line of credit. The debtor later sells the collateral to a buyer and the proceeds are used to reduce the operating line of credit. The secured party may be unaware that the collateral has been sold or that the proceeds have been used to reduce the indebtedness on the line of credit. The secured party may advance further funds in the belief that it will be able to look to the full value of the collateral. The secured party may argue that it did not know that the funds deposited into the bank account were proceeds, and that it would not have allowed the debtor to draw on the line of credit had it known that its ability to claim against the collateral was diminished.

An incorrect assessment of risk can occur even when the security interest does not secure future advances. A secured party, in deciding whether to forbear or to enforce its security interest, will likely consider, among other things, the extent to which its obligation is secured by the value of the collateral. This risk assessment assumes that the secured creditor can readily determine that it has priority to the collateral to the full extent of its obligation”.

In summary, there are strong arguments, on both statutory interpretation and policy grounds, in support of the conclusion that the statutory limitation on the secured party’s cumulative enforcement rights only applies where the secured party takes enforcement action to recover proceeds. These arguments were overlooked in both the IPS case and Kerwin and there is a case for statutory reforms to reverse the decisions. This is another issue currently under consideration by the Ontario PPSL Committee.

(c) The meaning of “proceeds”

OPPSA, section 1(1) defines “proceeds” to mean:

Identifiable or traceable personal property in any form derived directly or indirectly from any dealing with collateral or the proceeds therefrom [including]

\[\ldots\]

(d) any payment made in total or partial discharge or redemption of an intangible, chattel paper, an instrument or investment property”.
In the other provincial PPSAs, the definition is limited to property “in which the debtor acquires an interest”. Applying this limitation to the facts of Example 5, above, the $225,000 collected by Factor on Date 3 is not “proceeds” and so Bank’s security interest does not extend to these funds.

In the IPS case, the court held that the money collected by the factor on the assigned accounts was “proceeds” within the meaning of OPPSA, section 1(1). On a literal reading, this conclusion is correct because the provision does not limit proceeds to property “in which the debtor acquires an interest”. In other words, there is no “debtor interest limitation” as there is in the other provinces. On the other hand, the court recognized that “sequential dealings with collateral could generate more than one set of proceeds and create uncertainty with respect to the extent of a third party’s liability”. As explained in more detail below, the debtor interest limitation addresses this concern and the court in the IPS case could have read the Ontario definition as by implication being subject to the limitation. The court was prepared to take an expansive approach to the interpretation of OPPSA, section 25(1) and it is unclear why it failed to take a similar approach to the interpretation of the proceeds definition.

Wood summarizes the reasons for the debtor interest limitation as follows:

“The first concerns the geometric multiplication of proceeds claims. The second concerns the relative strength of the proceeds claim. Both can be illustrated through use of an example. Suppose that SP is granted a security interest in D’s auger. D sells it to B1 and it is later resold by B1 to B2, and then by B2 to B3. In addition to SP’s claim to the auger in the hands of B3, SP will have a right to enforce against the proceeds in the hands of D, B1 and B2. This opens up the possibility to a further multiplication of proceedings claims. Every time the proceeds are dealt with, additional proceeds claims arise. Suppose that B1 and B2 acquire rights in trade-in implements in respect of their respective sales. The trades are later sold by B1 to B4 and by B2 to B5. SP can assert a claim to the trades in

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45 Ibid., s.2(1).
46 However, Bank might have a personal claim against Factor for recovery of an amount up to the value of its collateral shortfall ($75,000): see Part (d), below.
48 Wood, op.cit. at 365-366.
49 Ibid. at 366-367.
the hands of B4 and B5, and can also claim the proceeds received by B1 and B2 in connection with these re-sales. Because SP is not required to elect between enforcement against the collateral and enforcement against its proceeds and is permitted to claim against multiple generations of proceeds, this soon produces an astonishing number of proceeds claims in the absence of a debtor interest restriction.

Under prior law, the problem of geometric multiplication of claims was ameliorated by the fact that the proceeds claim was subject to a significant limitation. It could not be asserted against a bona fide purchaser who acquired legal title for value and without knowledge. An innocent party who acquired the asset for value and without knowledge was therefore protected. The same does not hold true under the PPSA. Subject to a few exceptions, a claim to proceeds enjoys the same priority status as the claim to the original collateral. Consider the position of B4 and B5 who purchase the trades that are held by B1 and B2 as proceeds. Despite the fact that they may have bought the goods for value and without knowledge, they are subject to SP’s proceeds security interest in the trades. This holds true even though the sales may have occurred in the ordinary course of business. The ordinary course buyer rule of the PPSA allows the buyer to take free of any security interest granted by the seller. The rule is inapplicable because the security interest was not granted by their seller, but by a former owner (D).

Nor can B4 and B5 protect themselves by conducting a search of the registry. SP’s claim to proceeds is perfected under the OPPSA so long as the registration in respect of the collateral remains effective. A search by B4 or B5 using the name of their sellers (B1 or B2) would not reveal the security interest, as it was D who granted it. The outcome will differ only if SP knew of the unauthorized sale and failed to amend its registration within 30 days. In this event, the security interest in both the collateral and the proceeds will become unperfected, and a buyer who thereafter takes without knowledge will prevail”.

On the other hand, Ziegel and Denomme oppose the debtor interest limitation for the following reasons: 50

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“[the] difficulties are exaggerated and it is open to question whether the difficulties of searching in the case of non-cash proceeds are greater than in the case of original collateral. In any case, in many cases the transferee will have the protection of one of the provisions in ss.28-29. Even if this were not so, to restrict the secured party to proceeds that were received by the debtor would err too much in the opposite direction. Consider, for example, the following hypothetical. D, a debtor under a security agreement with SP, sells the collateral, a used vehicle (V1), to M, a used car dealer. M resells the vehicle to T and receives in part payment another used vehicle (V2). If SP’s rights were restricted to the original collateral (V1) and to proceeds received by D, SP would be entitled to follow V1 into T’s hands but not to claim V2 from M. This would be true even though M was in a much better position to search D’s title (and therefore to learn of SP’s interest) than was T.”

Ziegel and Denomme do not explain why they think the difficulties caused by an unrestricted definition of proceeds are exaggerated; on the contrary, the Wood passage quoted above suggests that there is legitimate cause for concern. Ziegel and Denomme argue that in many cases, the transferee will have the protection of the cut-off provisions in OPPSA, sections 28-29; but Professor Wood effectively refutes this argument. Finally, Ziegel and Denomme argue that a debtor interest limitation is undesirable because it would prejudice parties like T in their example; but this argument overlooks the potential prejudice to parties like B4 and B5 in Wood’s example if there is no debtor interest limitation.

There are additional arguments in support of the debtor interest limitation. First, the debtor interest limitation simplifies the law (by eliminating the potential for the geometric multiplication of proceeds claims) and therefore it reduces litigation costs. Secondly, the debtor interest limitation on the secured party’s rights can be seen as a *quid pro quo* for the secured party’s cumulative entitlements under OPPSA, section 25(1). Under pre-PPSA law, the secured party was required to elect between the original collateral and the proceeds and, in this respect, it is substantially better off under the PPSA. By facilitating proceeds claims, the PPSA increases the potential prejudice to third parties. The debtor interest limitation ameliorates this consequence and it can reasonably be characterized as a small price for the secured party to pay for its improved position under the PPSA. The Ontario PPSL Committee is currently considering
whether for these reasons, and also in the interests of inter-provincial harmonization, Ontario should adopt the same restriction.

(d) The secured party’s personal claim

Example 6, below, is a further variation on the facts of the IPS case.

Example 6. On Date 1, Bank opens a line of credit in Debtor’s favour and takes a security interest in Debtor’s present and after-acquired inventory and accounts to secure repayment. Bank registers a financing statement on the same day. Debtor draws $500,000 on the line of credit. On Date 2, Debtor enters into a factoring agreement assigning a block of accounts to Factor. The face value of the accounts is $275,000 and the agreed price is $200,000. Factor pays Debtor and Debtor deposits the money in a separate account where it remains traceable. On Date 3, Factor collects on the accounts, recovering a total of $225,000; Factor pays this money into a bank account where it remains traceable. On Date 4, Bank finds out about the Date 2 and Date 3 events and takes steps to enforce its security interest, claiming the $200,000 Debtor received from Factor on Date 2 and the $225,000 Factor collected from the account debtors on Date 3.

Outside Ontario, Bank’s security interest does not extend to the $225,000 in Factor’s hands because these funds are not proceeds of Bank’s original collateral. The position would be the same in Ontario if the reforms discussed in Part (c), above, were adopted. However, although Bank cannot assert a proprietary claim against Factor, it may have a personal claim for damages on the basis that, by collecting the accounts on Date 3, Factor wrongly interfered with Bank’s collateral. Bank’s cause of action may lie in conversion, although there is considerable doubt as to whether the doctrine of conversion applies to intangible property. 51 Alternatively, Bank may have a cause of action based on unjust enrichment, although again the law is unsettled. 52

51 The conventional view is that the tort of conversion only protects possessory interests and so it does not apply to intangible property: OBG v. Allen [2008] 1 A.C. 1 (H.L.). But there was a strong dissent in Allen and the decision has been criticized: see, e.g., Sarah Green and John Randall, The Tort of Conversion (Hart Publishing Oxford, 2009) at 128-129; Wood, op.cit. at 369-370.

52 The basis of the unjust enrichment is “interceptive subtraction”: Factor was enriched at Bank’s expense in the sense that the account debtors conferred a benefit on Factor that was destined for Bank, and that would have accrued to Bank but for Factor’s interception: see Ronald C.C. Cuming, “Secured Creditors’ Non-Statutory Remedies: Unfinished Business” (2012) 91 Canadian Bar Review 243 at 267, citing C. Mitchell, P. Mitchell and S. Watterson, Goff & Jones’ Law of Unjust Enrichment (8th ed., Sweet & Maxwell, London, 2011) at paras 6-52 – 6-662.
Assuming Bank can sue Factor in addition to enforcing its security interest against Debtor, in principle it should recover no more in total than the market value of its collateral on Date 2 ($275,000). In other words, if Bank claims the $200,000 in Debtor’s hands and subsequently sues Factor, its damages should be no more than $75,000. Correspondingly, if Bank successfully sues Factor for the $225,000, its claim against Debtor should be limited to $50,000.

The PPSAs, as currently drafted, provide (or in Ontario’s case, imply) that where a secured party enforces its security interest against both the original collateral and proceeds, the amount secured by the security interest in the collateral and the proceeds is limited to the market value of the collateral at the date of the dealing which gave rise to the proceeds. This provision only applies where the secured party enforces its security interest against both the original collateral in the transferee’s hands and the proceeds in the debtor’s hands; it does not cover the case where the secured party enforces its security interest against the debtor and brings a damages claim against the collateral transferee. The Ontario PPSL Committee is considering whether the provision should be extended to cover both cases.

5. Conclusion

The Secured Transactions Law Reform Project is an investigation into the desirability or otherwise of reforming the law of secured lending in England and Wales along the line of the Article 9 and Canadian PPSA models. As everyone knows, the issue is a contentious one and its resolution has been a long time coming. But even if the decision is ultimately against wholesale adoption of Article 9/PPSA reforms, many of the specific issues that arise under the Article 9/PPSA model should still be of interest to audiences on this side of the Atlantic. Keeping an eye on current developments in the Article 9/PPSA jurisdictions may draw attention to issues that English courts have not yet had an opportunity to consider and it may facilitate a richer debate on issues that have previously come to light. These, of course, are the benefits of comparative scholarship and they are worth pursuing independently of the ongoing debate concerning the Article 9/PPSA model’s commitment to substance over form.

The three topics discussed in this paper - security interests in statutory and contractual licences, security interests in cash collateral and security interests in proceeds – all transcend the
substance-over-form debate in the sense that all three issues are just as likely to surface in an English court applying English law as it currently stands, as they are in a Canadian court charged with applying the PPSA. All three issues have proved to be challenging in the Canadian context, as indicated by the failure so far to achieve definitive solutions. But the debates have been illuminating and with luck the Ontario PPSL Committee’s efforts will bear fruit in the end. In the meantime, the committee’s work should at least serve as a catalyst for further scholarship in Ontario, Canada and internationally.