

THE ENFORCEMENT OF DEMAND DEBENTURES— CONTINUING UNCERTAINTIES

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In R.E. Lister Ltd. v. Dunlop Canada Ltd., the Supreme Court of Canada held that a debtor is entitled to receive reasonable notice before a secured party can enforce a demand debenture. The Supreme Court also made it clear that notice means more than sufficient time to enable the debtor to withdraw money from an existing facility. Since Lister many Canadian courts have wrestled with the question of what amounts to a reasonable time, the Ontario Court of Appeal's decision in Kavcar Investments Ltd. v. Aetna Financial Services Ltd. being only the most recent effort. The author argues that the Canadian law remains very uncertain and that Kavcar has substantially added to the uncertainty. He accordingly feels that a statutory solution is now appropriate and he offers some specific proposals.

La Cour suprême du Canada, dans l'affaire R.E. Lister Ltd. c. Dunlop Canada Ltd., a décidé que le débiteur a droit à un préavis avec délai raisonnable avant que le créancier garanti puisse se faire rembourser une obligation payable sur demande. La Cour suprême a précisé de plus que le préavis doit laisser une période de temps plus longue que le temps requis pour retirer l'argent d'un compte. Depuis cette décision nombre de tribunaux canadiens ont du mal à décider du sens à donner à "délai raisonnable". Le jugement rendu récemment par la Cour d'appel de l'Ontario dans l'affaire Kavcar Investments Ltd. c. Aetna Financial Services Ltd. en est un autre exemple. Selon l'auteur le droit canadien reste peu clair dans ce domaine et le jugement de Kavcar a rendu la question moins claire encore. Il pense donc qu'il est temps de donner au problème une solution législative et il présente quelques suggestions précises.

Introduction

*Kavcar Investments Ltd. v. Aetna Financial Services Ltd.*¹ (hereafter *Kavcar Investments* or *Kavcar*) is the latest in a line of appellate decisions in Canada² wrestling with the question of how much notice a debtor is entitled

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This article began as a case comment and then mushroomed into this larger product. Nevertheless, its origins are still betrayed by its structure and by the light footnoting. I am indebted to John Farrar, George Triantis and Stephen Waddams for reading an earlier version of this paper and for making valuable suggestions for its improvement. Paul Vergelers deserves warm thanks for assisting in the research.

¹ (1989), 62 D.L.R. (4th) 277, 70 O.R. (2d) 225 (Ont. C.A.).

² See, *inter alia*, *Royal Bank of Canada v. Cal Glass Ltd.* (1979), 18 B.C.L.R. 55 (B.C.S.C.), appeal dismissed by consent (1980), 22 B.C.L.R. 328 (B.C.C.A.); *Ronald Elwyn Lister Ltd. v. Dunlop Can. Ltd.*, [1982] 1 S.C.R. 726, (1982), 135 D.L.R. (3d) 1; *Mister Broadloom Corp. (1968) Ltd. v. Bank of Montreal* (1983), 4 D.L.R. (4th) 74, 44 O.R. (2d) 368 (Ont. C.A.), revg. (1979), 101 D.L.R. (3d) 713, 25 O.R. (2d) 198 (Ont. H.C.);

to receive before a creditor can enforce a secured debenture or other security agreement requiring payment of the amount secured on demand,³ and when the creditor can authorize a privately appointed receiver to take possession of the debtor's business. *Kavcar Investments* is a unanimous decision of the Ontario Court of Appeal in which the court's judgment was written by McKinlay J.A. Despite the obvious care with which she prepared her judgment, we must regretfully conclude that it fails to bring certainty and clarity to an important branch of finance law that has become notorious for the lack of both qualities. Unhappily, as will be seen,⁴ her judgment adds to the prior uncertainty by stating categorically that nothing in the debenture can deprive the debtor of the right to reasonable notice⁵ before payment will be deemed to be in default and the receiver can proceed to take possession. Another difficulty arises from her assertion that even a stipulation in the debenture deeming the debtor to be in default on the happening of described events cannot deprive the debtor of the right to reasonable notice.

I. *The Facts in Kavcar Investments*

McKinlay J.A.'s judgment⁶ does not give us the benefit of a detailed statement of facts. However, we may infer from her summary of them that what we have here is the familiar saga of a once prosperous family business that has fallen on evil days, largely, it would seem, through an unwise investment. *Kavcar* was a closely held Ontario corporation of which Ernest

C.I.B.C. v. Prosser (1982), 41 N.B.R. (2d) 656 (N.B.C.A.); *R.E. Lister Ltd. v. Dayton Tire Canada Ltd.* (1985), 52 O.R. (2d) 88 (Ont. C.A.); *Royal Bank of Canada v. Eastabrooks Pontiac Buick Ltd.* (1985), 17 D.L.R. (4th) 75, 60 N.B.R. (2d) 160 (N.B.C.A.); *Clunie Enterprises Ltd. v. Melfort Credit Union Limited* (1986), 49 Sask. R. 131, 60 C.B.R. (N.S.) 129, (Sask. Q.B.), affd. (1988), 66 Sask. R. 112, 68 C.B.R. (N.S.) 220 (Sask. C.A.); *Roynat Ltd. v. Northern Meat Packers Ltd.* (1986), 29 D.L.R. (4th) 139, 71 N.B.R. (2d) 212 (N.B.C.A.); *Bank of Nova Scotia v. Ham* (1986), 29 D.L.R. (4th) 427, [1986] 5 W.W.R. 249 (Sask. C.A.); *Whonnock Industries Ltd. v. National Bank of Canada* (1987), 42 D.L.R. (4th) 1, [1987] 6 W.W.R. 316 (B.C.C.A.).

This article is only concerned with the common law position in Canada. For discussions of the Quebec position, see Louis Payette, *Prise de possession: demande de paiement et délai raisonnable*, in 1981 Meredith Memorial Lectures and Joyce Goodman-Mailhot, *Comment*, Ontario Lawyers Weekly, 27 November 1987, at p. 14.

³ In non-PPSA jurisdictions the security typically consists of a fixed and floating charge over all of the debtor's assets. In a PPSA jurisdiction the security will often be described as a general security interest in all of the debtor's assets with such further details as may be required by the statutory regulations of the jurisdiction in which the financing statement is filed. The secured party is free to continue to use fixed and floating charge terminology, but it is not recommended. See, further, J.S. Ziegel (1989), 5 B.F.L.R. 31, at pp. 37-39.

⁴ *Infra*, at p. 727

⁵ The judgments speak interchangeably of the debtor's right to "reasonable notice" or to "a reasonable period of time" before the debtor will be deemed to be in default. This article also uses the expression interchangeably.

⁶ *Supra*, footnote 1, at pp. 278-280 (D.L.R.), 226-228 (O.R.).

and Julius Weiss were at all relevant times the sole directors, officers and shareholders. Prior to the incorporation of Kavcar in November 1977, the Weiss brothers had been successful businessmen "involved primarily in the electrical and general contracting business in the Montreal area".

Early in 1978, Kavcar purchased from a receiver the assets of a bankrupt wholesale and retail hardware business in Ottawa. Neither of the Weiss brothers had had any previous experience in retailing or in the hardware business.

From January 1978 until May 1979, all of the Kavcar financing was provided by the Toronto-Dominion Bank and was secured, *inter alia*, by a demand debenture over Kavcar's assets. By the spring of 1979 the Bank had "classified" the Kavcar loan, and had reduced the company's line of credit to \$700,00 pending a complete review of the company's business position. To quote McKinlay J.A., "[a]lthough the bank had not called the Kavcar loan, it undoubtedly considered its advances at some risk, and was requiring regular pay-downs on its loans".⁷

It is not clear what became of the Bank's advances but presumably they were paid off. In any event, one Malcom Clarke, a former employee of the Toronto-Dominion Bank who had joined Aetna Financial Services ("Aetna"), became actively involved in Kavcar's financial affairs. Eventually he recommended to Aetna in the spring of 1979 that Aetna provide a diversified line of credit to Kavcar of up to \$1 million. The operating committee approved the credit but only up to \$900,000 and subject to downward fluctuations depending on the quantity of accounts receivable and inventory available as security. The borrowings were to be secured, *inter alia*, by a demand debenture, a factoring agreement, and a mortgage over real property owned by the Weiss brothers.

Aetna continued to finance Kavcar but "with increasing apprehension" until February 7, 1980. On this date Aetna demanded payment of all its advances and appointed Coopers & Lybrand as receiver. It was common ground that the receiver was appointed immediately on the making of the demand but that Coopers & Lybrand did not take possession until about three hours later. Even then the receiver stayed its hand for another six weeks before selling off the assets covered by the debenture.⁸

The plaintiffs took the position that three hours' notice did not constitute sufficient time to enable Kavcar to raise the money to pay off Aetna, and they sued Aetna for trespass and in conversion. Hollingworth J., at trial, agreed that the plaintiffs' complaints were well founded and, in addition, "was not persuaded that Kavcar would have been unable to raise the funds if a reasonable time had been given".⁹ Unfortunately McKinlay J.A.

⁷ *Ibid.*, at pp. 279 (D.L.R.), 227 (O.R.).

⁸ *Ibid.*, at pp. 291 (D.L.R.), 239 (O.R.).

⁹ *Ibid.*

provides no details of the evidence on which the trial judge based this finding, even allowing for its highly conditional nature. Since claims about the availability of other funding sources are often made by debtors in this type of case without adequate substantiation, it would have been helpful to know what evidence was presented to Hollingworth J.¹⁰ He did not assess damages himself but directed a reference to the Master to determine damages on the basis indicated in the reference. The important question of the measurement of damages for the creditor's trespass and conversion will be dealt with later in this article.

II. *The Court of Appeal's Reasoning*

The Court of Appeal affirmed Hollingworth J.'s finding that Kavcar had not been given sufficient time before the receiver went into possession and, with one modest qualification, also approved his directions on the quantification of damages. Neither of these results was surprising, given the long line of cases since 1982 on what constitutes adequate time and given Morden J.A.'s judgment in *Ronald Elwyn Lister Ltd. v. Dayton Tire Canada Ltd.*¹¹ on the principles governing the measurement of damages. What add distinctive new notes are McKinlay J.A.'s analyses of the purpose of the reasonable time requirement, to what extent it may be reduced or even eliminated by the debtor's subjective circumstances, and whether the requirement is a rule of law or an implied term of the parties' agreement. Finally, she considered the important question whether the reasonable time requirement also applies to cases where, under the terms of the debenture, the creditor is entitled to enforce its security and appoint a receiver on the happening of prescribed events, *without* making a demand for payment on the debtor.

A. *The Scope and Purpose of the Reasonable Time Requirement*

The *locus classicus* of the current Canadian law on these points is Estey J.'s judgment for the Supreme Court of Canada in *Ronald Elwyn Lister Ltd. v. Dunlop Canada Ltd.*¹² It is curious that it should have assumed such an exalted position since the issue before the Supreme Court was a much narrower one: whether the debtor must ask for time to raise the money after demand for payment is made upon him. Not surprisingly Estey J. answered no, given his conclusion that the debtor's right to a reasonable period of time derived from the parties' agreement and not from conditions obtaining at the time of the creditor's demand.

¹⁰ The information would have been particularly interesting in the light of the trial judge's finding (*ibid.*, at pp. 293 (D.L.R.), 240 (O.R.)) that at the time of the conversion Kavcar had a nil value on a going concern basis.

¹¹ *Supra*, footnote 2.

¹² *Supra*, footnote 2.

For his major proposition Estey J. relied on two frequently cited but in themselves not very remarkable nineteenth century English decisions, *Toms v. Wilson*¹³ and *Massey v. Sladen*.¹⁴ As McKinlay J.A. notes in *Kavcar*,¹⁵ these two decisions turned on their own peculiar facts—the fact that in *Toms v. Wilson* the debtor was not at home when the demand for payment was presented, and that in *Massey v. Sladen* the demand for payment was made not by the creditor personally but by his agent. Certainly neither of these cases, nor any subsequent English authority, justify the broad reading of a generous borrower's equity which Estey J. distilled from them. Modern English and other Commonwealth authorities¹⁶ have, with minor exceptions, only applied a “mechanical” time of payment test and merely allowed the debtor sufficient time to withdraw the cash needed from an existing facility.

It is a conjectural point whether Estey J. consciously added a generous gloss to the nineteenth century decisions or whether he really believed that the English judges were enunciating a general doctrine of reasonable notice sufficient to allow the debtor to raise funds from a new source. The first answer is probably the correct one. This is because he alluded to the economic duress¹⁷ under which a debtor labours when faced with an immediate demand for the payment of a large sum of money, and because he must have been aware of at least two relatively recent lower court Ontario decisions consciously departing from the mechanical time of payment test.¹⁸

Subsequent Canadian courts have not agonized over the apparent discrepancy between the English decisions and Estey J.'s reading of them, but have loyally applied the debtor's entitlement to reasonable time embraced by the Supreme Court. But reasonable time to what end, and what constitutes a reasonable period of time?

McKinlay J.A. did not think Estey J. had answered the first question directly but she thought that the answer was implicit in the factors which

¹³ 4 B. & S. 442, 122 E.R. 524, affd. 4 B. & S. 455, 122 E.R. 529 (Exch. Ch.).

¹⁴ (1868), L.R. 4 Ex. 13.

¹⁵ *Supra*, footnote 1, at pp. 282-284 (D.L.R.), 230-232 (O.R.).

¹⁶ See, e.g., *Cripps (Pharmaceuticals) Ltd. v. Wickenden*, [1973] 1 W.L.R. 944, [1973] 2 All E.R. 606 (Ch. D.); *Bank of Baroda v. Panessar*, [1987] Ch. 335, [1986] 3 All E.R. 751 (Ch. D.); *Bunbury Foods Pty. Ltd. v. National Bank of Australasia Ltd.* (1984), 153 C.L.R. 491, 51 A.L.R. 609 (H.C.A., *per incuriam*); *ANZ Banking Group (N.Z.) Ltd. v. Gibson, Newton and Gray*, [1986] 1 N.Z.L.R. 556 (C.A.).

¹⁷ *Supra*, footnote 2, at p. 746 (S.C.R.), 16 (D.L.R.).

¹⁸ *West City Motors Ltd. v. Delta Acceptance Corp. Ltd.* (1963), 40 D.L.R. (2d) 818 (Ont. H.C.), followed by *Rutherford J. in R.E. Lister Ltd. v. Dunlop Canada Ltd.* (1978), 85 D.L.R. (3d) 321, 19 O.R. (2d), 15 O.R. (2d) 155n (Ont. H.C.), and *Mister Broadloom Corporation (1968) v. Bank of Montreal* (1979), 101 D.L.R. (3d) 713, 25 O.R. (2d) 198 (Ont. H.C.), revd. on other grounds (1983), 4 D.L.R. (4th) 74, 44 O.R. (2d) 368 (Ont. C.A.).

Linden J. enumerated in *Mister Broadloom*¹⁹ as relevant in determining what amounts to reasonable time and to which Estey J. referred to with approval. This was, barring extenuating circumstances, to give the debtor a reasonable period of time to raise the money elsewhere, whether by liquidating existing assets, refinancing the loan, or by other means. Few will quarrel with this objective; many will regard it as all too obvious. But why should it be the only one, once we abandon the narrow mechanical English test? Why should the debtor not also be allowed a reasonable period for other purposes—for example, to recover from the shock of learning that he is about to lose a business in which he may have invested much effort and resources, and perhaps to reopen negotiations with the creditor to see whether a compromise solution cannot be worked out between them?

It makes a difference whether we assign one or several purposes to the reasonable time requirement. If there is only one purpose, to allow the debtor time to raise the money, then the debtor may not be entitled to any time if it is clear that she will not be successful in her quest. This clearly emerges from recent case law to which McKinlay J.A. referred with approval.²⁰ If the purpose of giving a reasonable amount of time is broader and more equitable, then the debtor should be entitled to a reasonable amount of time regardless of her financial condition.

B. *What is a Reasonable Period of Time?*

From the parties' point of view this is obviously a critical question, particularly since it has given Canadian courts so much difficulty. One starting point would be to ask whether the court is merely construing the "true" meaning of the creditor's entitlement to ask for payment on demand or whether the court is applying an external standard of reasonableness regardless of what the parties contemplated or intended. Prior Canadian courts have not approached the issue from this latter perspective. As I have already mentioned, McKinlay J.A. made it clear that the debtor's entitlement derived from a rule of law and was not dependent on the

¹⁹ *Ibid.*, at pp. 723 (D.L.R.), 208 (O.R.) (Ont. H.C.):

Thus, a reasonable length of time must always be allowed, but in assessing what length of time is reasonable in a particular fact situation various factors must be analyzed: (1) the amount of the loan; (2) the risk to the creditor of losing his money or the security; (3) the length of the relationship between the debtor and the creditor; (4) the character and reputation of the debtor; (5) the potential ability to raise the money required in a short period; (6) the circumstances surrounding the demand for payment; and (7) any other relevant factors.

²⁰ *Supra*, footnote 1, at pp. 288-290 (D.L.R.), 236-238 (O.R.). The cases are *C.I.B.C. v. Quesnel Machinery* (1985), 62 C.B.R. (N.S.) 92 (B.C.S.C.); *263121 Ontario Limited v. Toronto-Dominion Bank*, unreported, Ontario, Sept. 27, 1984. The latter case was also relied on by Carruthers J. in *Royal Bank v. Starr* (1987), 41 D.L.R. (4th) 715, 61 O.R. (2d) 6 (Ont. H.C.).

parties' agreement. This challenging proposition will be examined more closely later in this article. For the moment it is sufficient to note that it appears to have exerted little influence on her construction of the meaning of reasonable time. Instead, she limited herself to the enquiry of how much time the debtor should be given to try and raise the money to pay off the creditor.²¹

The question is much easier put than answered. Do we adopt an objective standard or a subjective one, a combination of both, or neither standard? If the reasonable time requirement is an objective one, how is the reasonable time determined and at what point in time? Will the answer depend on expert evidence on how long it would have taken a reasonably solvent debtor to raise the money when the demand for payment was made, assuming the debtor was not conveniently carrying the right amount in his pocket? A moment's reflection will show that a "reasonably solvent debtor" is a legal abstraction and that even an objective standard must include subjective elements such as the debtor's line of business, the make up and size of the assets, the ownership structure of the business and, arguably, whether or not, in the case of a closely held business, the owners could be expected to dig into their own pockets.

It is one of the distinctive features of the post-*Lister v. Dunlop* cases that none of them has really come to grips with these complex questions, thus challenging the soundness of the departure from the English mechanical time of payment test to begin with, as well as adding to the uncertainty of the parties' position. In *Kavcar*, McKinlay J.A. also made no attempt to adopt what lawyer economists would call a "principled" position. Instead she appears to favour an amalgam of objective and subjective tests and a strong dose of pragmatism but with only a limited attempt to justify these varying approaches.

Taking as her starting point the previously noted proposition that the purpose of giving a reasonable amount of time is to enable the debtor

²¹ In *Bank of Baroda v. Panessar*, *supra*, footnote 16, Walton J. held that it was not necessary for the creditor to specify the actual amount owing at the time of the demand for payment where it was difficult to ascertain because of the complexity of the dealings between the parties. He thought the amount could be determined when the debtor indicated his willingness and ability to make payment.

The same position was adopted by the High Court of Australia in *Bunbury Foods*, *supra*, footnote 16, where the court rationalized the accommodation on the grounds that in complex accounts it would be difficult for the creditor to produce an exact figure at short notice.

It would be surprising if a Canadian court were willing to show the creditor the same indulgence. The ready availability of computerized accounts should take care of the accounting difficulties. An Ontario court would also be influenced by the fact that s. 63(5)(b) of the Ontario Personal Property Security Act, 1989, S.O. 1989, c. 16, requires the secured party to forward the debtor a notice containing, *inter alia*, the amount owing by the debtor before the collateral is sold by the secured party. This provision has deep roots in pre-OPPSA law and has not given rise to serious compliance difficulties.

to refinance the loan, she was then faced with the apparent "incongruity" that "the more hopeless a debtor's financial plight, the more time he must be given to satisfy a demand for payment".²² She was satisfied that this was not the law and, instead, that "the law in Canada at the present time requires that a debtor, following a proper demand for payment, must be allowed a reasonable time to raise the necessary funds to satisfy the demand. What constitutes reasonable time will depend on the circumstances, but will generally be of very short duration".²³ She justified the rejection of a purely subjective test on at least two grounds: "first, if the assets secured are of insufficient value to satisfy the indebtedness, the creditor's loss increases daily, and second, if the debtor would be unable to raise the funds even if given time, then time will avail the debtor nothing."²⁴

McKinlay J.A. did not define what she meant in stating that the period allowed the debtor would generally be of a very short duration, but it is clear she had in mind the British Columbia Court of Appeal's decision in *Whonnock Industries Ltd. v. National Bank of Canada*.²⁵ In that case the creditor had given the debtor seven days in which to meet the creditor's demand for payment. The trial judge found it was insufficient and that the debtor should have been given thirty days. In reversing this finding Seaton J.A. observed:²⁶

The Canadian law demonstrated in the decisions does not contemplate more than a few days and cannot encompass anything approaching 30 days. In the decisions noted nothing approaching the seven days permitted here has been classed as unreasonable. The cases in which the requirement for reasonable notice evolved deal with notices of an hour or less. None of them holds that a notice of more than one day was inadequate and none refers to the need for a notice of more than a few days.

Seaton J.A. did not explain how even a reasonably solvent debtor could be expected to refinance a large sum of money in a few days (and even less in a day) nor did McKinlay J.A., although she was satisfied that the above passage was "a fair summation, I believe, of the cases decided to date".²⁷ The answer, presumably, is that the courts are not purporting to apply a strictly objective test based on even an average debtor's needs but are attempting to balance the creditor's interests with at least a limited opportunity to the debtor to raise the money needed.

In *Kavcar*, Aetna argued²⁸ that even a few days' notice was too much if it could prove that it would not have helped the debtor, as it claimed was true in the present case, so that the plaintiffs had not been prejudiced

²² *Supra*, footnote 1, at pp. 287 (D.L.R.), 235 (O.R.).

²³ *Ibid.*

²⁴ *Ibid.*

²⁵ *Supra*, footnote 2.

²⁶ *Ibid.*, at pp. 11 (D.L.R.), 327 (W.W.R.).

²⁷ *Supra*, footnote 1, at pp. 288 (D.L.R.), 236 (O.R.).

²⁸ *Ibid.*

by any deficiency of notice on Aetna's part. Aetna relied on two first instance decisions to support its contention. The first was McLachlin J.'s decision in *C.I.B.C. v. Quesnel Machinery Ltd.*,²⁹ the second, Saunderson J.'s unreported decision in *263121 Ontario Limited v. Toronto-Dominion Bank*.³⁰ McKinlay J.A. conceded³¹ that "there are situations in which it is reasonable for a lender to demand payment and almost immediately thereafter enforce its security" and that *Quesnel Machinery* and *Toronto-Dominion* provided examples of them. She cautioned however that the burden was on the creditor to show why, in the particular circumstances, the period allowed was reasonable and that the creditor would be running a serious risk if a court subsequently disagreed with its claim that more time would not have done the debtor any good. McKinlay J.A. did not indicate whether the creditor must also prove that it honestly believed the debtor to be completely insolvent at the time of making the demand for payment.³²

To sum up, then, the court in *Kavcar* both rejected and affirmed a subjective test in determining what amounts to a reasonable period of time. It rejected it as a basis for giving an impecunious debtor more time to raise the money than would be necessary for a solvent debtor, and it adopted the subjective test to show that the debtor's insolvent position did not warrant her being given more than a nominal amount of notice. Arguably the two propositions can be collapsed into one and we then emerge with the following rule: only a solvent debtor is entitled to a reasonable period of notice to refinance the loan although even that period need only amount to a few days and perhaps as little as one day. If the creditor gives less than this amount of notice then it must be able to justify the shorter period. It can do so by proving the debtor's inability to benefit from a longer period of notice or by showing that the debtor had behaved dishonestly, or perhaps that the creditor had reasonable grounds for believing that the debtor would engage in skulduggery if given more time.

C. *The Importance of the Parties' Agreement*

It is always hazardous to attempt to reduce a substantial judgment to a few lines. But even if my summary of the effect of the reasoning in *Kavcar* is accepted as accurate, it still leaves too many imponderables for the comfort of creditors and debtors, but particularly for creditors' comfort. Why are the parties not free to make their own agreement with

²⁹ *Supra*, footnote 20.

³⁰ *Supra*, footnote 20.

³¹ *Supra*, footnote 1, at pp. 290 (D.L.R.), 238 (O.R.).

³² It may make a difference where the creditor is simply relying on its solicitor's advice that no more than a brief notice is necessary without adverting its mind to the state of the debtor's solvency. Presumably the answer is that it should not matter—that the sole test is whether a reasonable period of notice would have made a difference to the debtor's ability to respond to the demand for payment.

respect to the time of payment? Creditors would no doubt reply that this is precisely what the demand payment clause was intended to achieve, and that but for the Canadian courts' gratuitous addition of a large gloss the subsequent difficulties would not have occurred. On this view, the proper solution lies in a fair and natural construction of the demand payment clause and in a return to basic contract principles.

Before determining whether this is the right answer, we must first examine the source of the debtor's right to reasonable notice of the demand for payment or, what amounts to the same thing, to a reasonable period of time in which to meet the demand. There can, I think, be no doubt that the English cases view it exclusively as a question of contractual construction. It seems that Estey J. approached the issue from the same plane since he relied heavily on the nineteenth century English judgments even if (as might well be argued) he misconstrued them. There are hints in some later lower court judgments that the contractual approach was being abandoned in favour of a debtor's equity to being given a reasonable period of time. However, it is only in *Kavcar* that we find the first unambiguous confirmation of this important shift. This is what McKinlay J.A. writes:³³

I consider that the decision of the Supreme Court of Canada in *Lister v. Dunlop*, and the cases that have been decided since, preclude a creditor from realizing on security which secures an indebtedness payable on demand, *regardless of the wording of the security document*, unless a period of time which is reasonable in the circumstances has been given to the debtor to satisfy the demand.

I think she is clearly mistaken about *Lister v. Dunlop* but, leaving aside this issue, what rule of public policy leads a Canadian court to conclude that the parties' own apparent agreement must be disregarded in favour of an overriding principle of the debtor's right to reasonable time? Unfortunately McKinlay J.A. does not spell out her reasoning and we are left to draw our own inferences. If we exclude such traditional contract defences as misrepresentation, fraud or duress then the only viable explanation we are left with is that it is unconscionable for the creditor to rely on a contractual provision that entitles him to demand immediate repayment of the amount owing without giving the debtor a reasonable opportunity to refinance the loan. Yes, the argument will run, the debtor did indeed sign the demand debenture but he had no option. It was a standard form agreement and the demand payment clause was never negotiated between the parties. It is inconceivable, it will be argued, that a freely consenting debtor would agree to so draconian a condition that would place his business in constant jeopardy so long as any monies were outstanding.³⁴

³³ *Supra*, footnote 1, at pp. 280-281 (D.L.R.), 228 (O.R.). (Emphasis in the original).

³⁴ Such sentiments seem to have provoked the following lyrical passage in Wakeling J.A.'s judgment in *Bank of Nova Scotia v. Ham*, *supra*, footnote 2, at pp. 433 (D.L.R.), 256 (W.W.R.):

There is an obvious attractiveness about this line of reasoning and it seems to comport with Equity's traditional role of protecting the weaker bargaining party. Nevertheless, there are formidable difficulties. I will mention only a few. To begin with, there is still much uncertainty about the status and scope of the doctrine of unconscionability in Canada.³⁵ In England, Lord Denning's attempt in *Lloyds Bank Ltd. v. Bundy*³⁶ to establish an all embracing unconscionability doctrine has received little judicial support.³⁷ Instead, the courts have preferred to leave it to Parliament to determine legislatively to what extent the courts should be given a general policing power over the reasonableness of contractual stipulations.³⁸

In Canada, Lord Denning's efforts have received a more sympathetic reception and there are now a substantial, though by no means vast, number of consumer cases in which courts have been willing to grant relief from what they perceived to be unfair bargains.³⁹ The courts have been much more reluctant to intervene in commercial contracts and there are few cases in which they have done so under the cover of a doctrine of unconscionability. To be sure, Dickson C.J.C.'s recent judgment in *Hunter Engineering Co. v. Syncrude Canada Ltd.*⁴⁰ lends support to its availability in commercial transactions but his dicta are too general and vague to offer a firm basis of prediction as to the future course of judicial developments.

Even if this were not so, it is by no means obvious that a demand payment clause in a debenture document or similar financing instrument is so intrinsically one sided and unfair as to satisfy Lord Denning's criteria of unconscionability in *Lloyd's Bank v. Bundy* or the vaguer community sense of fairness favoured by Lambert J.A. in *Harry v. Kreutziger*.⁴¹ Lines of credit are not ordinarily negotiated under economic duress and it is

The remedy of appointing a receiver by a creditor must be viewed as extraordinary. If a home is a man's castle, no less is his business a product of much effort and financial investment and is therefore equally worthy of protection from unreasonable (*sic*) trespass and conversion.

³⁵ See, generally, S.M. Waddams, *The Law of Contract* (2nd ed., 1984), pp. 326-407; Ontario Law Reform Commission, *Report on Amendment of the Law of Contract* (1987), ch. 7; D. Vaver, *Unconscionability: Panacea, Analgesic or Loose Can(n)on?* (1988), 14 C.B.L.J. 40.

³⁶ [1975] Q.B. 326, [1974] 3 All E.R. 757 (C.A.).

³⁷ See, *National Westminster Bank v. Morgan*, [1985] A.C. 686, [1985] 1 All E.R. 821 (H.L.).

³⁸ The British Parliament has so legislated in the Unfair Contract Terms Act, 1977. See also, *Photo Production Ltd. v. Securicor Transport Ltd.*, [1980] A.C. 827, at p. 843, [1980] 1 All E.R. 556, at pp. 561-562 (H.L.), per Lord Wilberforce.

³⁹ The judicial intervention is now greatly strengthened by the business and trade practices legislation that has been adopted in several of the provinces, most notably in British Columbia and Ontario. The number of reported decisions in which the courts have exercised their statutory authority is painfully small.

⁴⁰ [1989] 1 S.C.R. 426, at p. 462, (1989), 57 D.L.R. (4th) 321, at pp. 341-342.

⁴¹ (1978), 95 D.L.R. (3d) 231 (B.C.C.A.).

very much in the debtor's interest to be able to draw down on the credit at will and not to be required to make repayments at stipulated intervals. Debtors may be unduly sanguine in believing that a "peremptory" demand for payment will never be made from them, but they have little excuse for not knowing that the power is there for the creditor to exercise if he wants to.⁴²

There are also other reasons that militate against McKinlay J.A.'s position. Although demand debentures have been in use since at least the turn of the century, it is only very recently that any serious suggestions have been put forward to regulate their enforcement legislatively and then only for reorganization purposes.⁴³ Again, as more fully discussed below,⁴⁴ none of the recently adopted or revised crop of personal security laws in Ontario, Alberta and British Columbia, or the earlier statutes in Manitoba and Saskatchewan, contain restrictions on the creditor's right in commercial security agreements to take possession of the collateral on the debtor's fault.⁴⁵ Nor do they generally require the creditor to give prior notice

⁴² Those courts that take the position that a demand payment clause is unconscionable must also explain how they reconcile this conclusion with Canadian courts' consistent willingness to enforce commercial guarantees, however onesided and draconian in character. The most notorious example is the Supreme Court of Canada's decision in *Bauer v. Bank of Montreal*, [1980] 2 S.C.R. 102, (1980), 110 D.L.R. 93 (3d) 424, in which the court enforced an exculpatory clause in a guarantee given by a director even though the Bank had negligently failed to perfect its security interest in the collateral given by the debtor.

McIntyre J., at pp. 110 (S.C.R.), 429-430 (D.L.R.), wrote on behalf of the court:

To the argument that the clause was onerous and unreasonable and that the bank could not rely upon it, various arguments were advanced. It was stressed that the guarantee was on a standard bank form, that it was drawn by a party seeking to rely upon the clause, that there was inequality between the parties, and that the clause was unusual in nature. I can find no merit in this position. While it is, of course, true that the guarantee was on the bank's standard form, it is difficult to say that the clause was unusual. It was the one the bank always used and the guarantor, an experienced businessman, admitted that he had signed three previous guarantees to the bank on the same form and that he knew the general scope and purpose of the guarantee and what it would require of him. The guarantor was a customer of the bank, he had been for some years. While I suppose it could be said that there is always a degree of inequality between borrower and lender, banker and guarantor, there was no such inequality here that would void the arrangements. Nor, in my opinion, can it be said that there was any unreasonableness in the arrangement. This contract concluded between the bank and the guarantor was an ordinary commercial transaction carried out between the bank and an experienced businessman in the same manner and upon the same terms as are employed daily in such matters. The contract created no unusual or onerous burden in ordinary commercial terms. I can find no merit in this argument.

⁴³ Report of the Advisory Committee on Bankruptcy and Insolvency: Proposed Bankruptcy Act Amendments (2nd ed., Min. of Supply & Services Canada, 1986), pp. 35-48.

⁴⁴ See, *infra*, Part II, E.

⁴⁵ The Prairie provinces and, to a more limited extent, British Columbia, have enacted a complex web of consumer and farmer oriented legislation imposing enforcement restrictions

of his intention to seize the collateral or to appoint a receiver. The oversight is not accidental since the legislation requires the secured party to give notice of his intention to dispose of the collateral *after* he has taken possession of it.⁴⁶

While this evidence is not conclusive, it does point to the general acceptability of demand payment and default provisions that have been regularly used for many decades or, if one prefers to be cynical, that testify to the effectiveness of creditors' voices in legislative halls. Finally, it is not irrelevant to remind ourselves that the Bills of Exchange Act⁴⁷ explicitly recognizes the propriety of demand bills and notes and gives them preferred treatment by not entitling the payee to the three day grace period applicable to non-demand instruments in calculating the time of payment. It would be odd to suggest that an unsecured instrument requiring payment on demand is highly respectable but that a secured demand instrument is suspect and requires close judicial supervision.⁴⁸

In questioning the basis of McKinlay J.A.'s assertion that the parties are not free to exclude the debtor's right to reasonable notice, I do not mean to suggest that all is well in the state of Denmark and that some restriction on the enforceability of demand debentures may not be necessary. I argue below however⁴⁹ that the judicial route is fraught with too much uncertainty and that a statutory solution is preferable.

on secured creditors. I exclude this legislation in referring to the creditor's enforcement rights in commercial transactions.

⁴⁶ See, e.g., Ontario Act, *supra*, footnote 21, ss. 63(4), 64(5).

⁴⁷ R.S.C. 1985, c. B-4, s. 23, s. 42.

⁴⁸ Given this dichotomy, it is presumably open to a debenture holder who also holds a demand promissory note relating to the same transaction to demand payment of the note without giving the debtor time to refinance the note. Having made such demand and not been paid, would the creditor also be entitled to declare the debenture in default and to send in the receiver without further notice? I know of no case in which this challenging point has been directly addressed, but a closely related issue was raised in *Royal Bank v. Eastabrooks Pontiac Buick Ltd.*, *supra*, footnote 2, at p. 80.

In this case, the Bank argued that the *Lister v. Dunlop* doctrine did not apply, and that it was not required to give notice before enforcing the debenture, because the "debenture under consideration is a promissory note by definition and the provisions of the Bills of Exchange Act apply . . .". In claiming that the debenture was a negotiable instrument the Bank relied both on the wording of the debenture and on the familiar "negotiation by contract" clause. The Bank raised no argument arising out of the fact that it had also taken separate promissory notes to evidence the indebtedness and had presented them for payment at its branch.

Hoyt J.A., *ibid.*, at pp. 80-81, rejected the Bank's argument on the ground that there was no difference between the wording of the debenture in the present case and the wording in *Lister v. Dunlop*. He did not examine the provisions of the Bills of Exchange Act or the effect of a negotiation by contract clause on the debtor's entitlement to notice.

⁴⁹ *Infra*, p. 743 *et seq.*

D. *Does the Lister v. Dunlop Doctrine Apply to Default Clauses and to Non-Demand Payment Security Agreements?*

Apart from the demand payment provision, it is common for debentures to contain an omnibus clause providing that the principal debt shall become "immediately payable", and the security enforceable, on the happening of any one of a number of prescribed events. Paragraph 5 of Kavcar's debenture contained such a clause.⁵⁰ Aetna argued that at the time of the appointment of the receiver Kavcar was in default under all of the provisions of paragraph 5 and that it was entitled to enforce the security without any demand for payment being made. In fact, Aetna's letter demanding payment stated only one ground of default—that Aetna considered itself insecure. Kavcar therefore argued that Aetna was not entitled to rely on any other ground.

McKinlay J.A. rejected the argument and held that so long as the debtor is not misled the creditor may rely on any default by the debtor when making a demand for payment.⁵¹ However, she also rejected Aetna's contention that "some types of default permit enforcement of the security

⁵⁰ Paragraph 5 of the debenture reads as follows:

5. The principal hereby secured shall become immediately payable and the security hereby constituted shall be enforceable in each and every of the events following:

- (a) If the Corporation makes default in any payment referred to herein, either in principal or interest, or in performing or observing any covenant, condition or obligation contained in this Debenture, or under the Factoring and Security Agreement between Aetna and the Corporation, and/or in any other agreement between Aetna and the Corporation.

....

- (d) If the Corporation becomes insolvent, or makes an authorized assignment for the benefit of, or proposal to its creditors, or a sale of its assets in bulk or commits any act of bankruptcy or permits a Bankruptcy Petition filed or presented against it to remain outstanding for more than two clear business days or if, by reason of any similar circumstances, Aetna, on reasonable grounds, in good faith considers itself insecure or the repayment of any sums secured hereby to be impaired.

....

- (i) If the Corporation makes a default under the provisions of the Factoring and Security Agreement between the Corporation and Aetna dated the 7th day of May, 1979 or any other agreement or instrument creating indebtedness or guarantee or a charge on assets of the Corporation. ...

⁵¹ *Supra*, footnote 1, at pp. 292 (D.L.R.), 239-240 (O.L.R.). Although she cites no authority for her ruling, it accords with the well established position in sales law where a party rejects goods or cancels a contract and subsequently seeks to justify its position on grounds other than those stated at the time of rejection or cancellation. See, for example, *Colfax Inc. v. General Foods Ltd.* (1980), 10 B.L.R. 174, at pp. 189-190 (Ont. H.C.), reviewing earlier English authorities. A modified version of the same rule appears in section 2-605 of the American Uniform Commercial Code.

without any demand for payment being made".⁵² Her reasons were as follows:⁵³

In my view, the law has developed to the point where, regardless of the wording of a debenture security, it cannot be enforced without first, the making of a demand, and second, the giving of a reasonable time within to pay the indebtedness. This was the opinion of Fawcus J. in *Royal Bank of Canada v. Cal Glass* ... and I agree.

A simple answer to Aetna's contention would have been that since it had in fact made a formal demand for payment it was estopped from arguing that no demand was necessary and that, having made the demand, it had to meet the usual notice requirement. However, since McKinlay J.A. relied on other grounds to justify a notice requirement we must see how strong they are.

*Royal Bank v. Cal Glass Ltd.*⁵⁴ involved a case where the bank appointed a receiver after giving the debtor only thirty minutes in which to meet the demand for payment. Fawcus J. applied Linden J.'s criteria in *Mister Broadloom Corp.*⁵⁵ as to what constitutes reasonable notice and held that, given all the circumstances, thirty minutes was sufficient.⁵⁶ The bank argued that no notice was required at all since under clause 5(c) of the debenture the secured debt became immediately payable if the debtor became insolvent. Although Fawcus J. found that the debtor was insolvent at the time of the demand for payment, he rejected the Bank's argument with the cryptic comment, "I agree with the submission of Mr. Hungerford [counsel for the debtor] that regardless of the nature of the breach, a demand for payment must always be made".⁵⁷

It seems surprising that the court in *Kavcar* was willing to accept such an unsatisfactory conclusory statement, particularly since better precedents were available. The issue was considered by the Ontario Court of Appeal in *Lister v. Dunlop*⁵⁸ where Dunlop likewise relied on a section 6 event as dispensing with the need for notice. Speaking for the court, Weatherston J.A. rejected the argument on the following grounds:⁵⁹

It may well be that the security became enforceable when default occurred, but that does not answer the question how soon Dunlop could move to enforce the

⁵² *Ibid.*, at pp. 292 (D.L.R.), 240 (O.R.).

⁵³ *Ibid.*

⁵⁴ *Supra*, footnote 2.

⁵⁵ *Supra*, footnote 2.

⁵⁶ The decision was appealed, (see, *supra*, footnote 2), but the appeal was subsequently dismissed by consent. Fawcus J. relied heavily on the fact that the principal owner of the debtor had not asked for time to make payment and had not indicated that he would be able to raise the money. Exactly the same grounds were held insufficient by the Supreme Court in *Lister v. Dunlop* to dispense with notice requirements, and it is safe to conclude that *Cal Glass* is no longer good authority for the actual decision.

⁵⁷ *Supra*, footnote 2, at p. 68 (B.C.S.C.).

⁵⁸ (1980), 105 D.L.R. (3d) 684, 27 O.R. (2d) 168.

⁵⁹ *Ibid.*, at pp. 690 (D.L.R.), 174 (O.R.).

security. If a term for payment "instantly on demand, and without delay on any pretence whatever"⁶⁰ can be construed as meaning that a reasonable time is to be allowed to meet the demand, then I think that the terms of s. 6.1 [of the debenture] should be construed as meaning that although the security became enforceable, it would not be enforced until the debtor had been given a reasonable time to make payment of the amount due.

It will be observed that Weatherston J.A. was not relying on any overriding principle of debtor-creditor law entitling the debtor to notice but was only engaging in a "reasonable" construction of the meaning of section 6.1 of the debenture.

In a more recent decision, *Jim Landry Pontiac Buick Ltd. v. CIBC*,⁶¹ Glube C.J.T.D. had to consider the effect of default provisions in demand conditional sale agreements and chattel mortgages⁶² given by the debtor in the Bank's favour. The Bank repossessed the vehicles covered by the agreements without giving prior notice and apparently relied on an "insecurity" provision in clause 4 of the "Conditions of Sale" to justify its action. The Bank argued that even if the *Lister v. Dunlop* doctrine applied to non-debentures, no time for payment was required where the creditor relied on a default clause as was true here.

Glube C.J.T.D. rejected both contentions. So far as the first issue was concerned, she read Estey J.'s judgment in *Lister v. Dunlop* as meaning that "the principles espoused in *Lister* do apply to 'debt-evidencing and creating documents'".⁶³ She rejected the second argument because she thought it unreasonable to expect the debtor to know what is in the creditor's mind where the creditor is relying on an insecurity clause. "Surely," she wrote, "it cannot be reasonable to have a default in the mind of the creditor without it being communicated to the debtor and allowing the debtor to respond to the purported default".⁶⁴ Her reasoning suggests that where the debtor knows, or ought to know, that she is in default, notice of default is not necessary. Nevertheless, and somewhat inconsistently, she states that the debtor must still be given a reasonable time for payment.⁶⁵

The Chief Justice qualified her conclusion in one important respect. She recognized that the Nova Scotia Conditional Sales Act⁶⁶ requires a repossessing seller to give notice to the buyer after repossession advising

⁶⁰ The quotation is from the terms of the bill of sale in *Massey v. Sladen*, *supra*, footnote 14.

⁶¹ (1987), 40 D.L.R. (4th) 343, 80 N.S.R. (2d) 308 (N.S.T.D.).

⁶² Demand conditional sale and chattel mortgage agreements are common in the auto trade since they serve the function of bridge financing until the dealer can resell the inventory of new and used vehicles.

⁶³ *Supra*, footnote 61, at pp. 355 (D.L.R.), 318 (N.S.R.). The phraseology is from Estey J.'s judgment in *Lister v. Dunlop*, *supra*, footnote 2, at pp. 746 (S.C.R.), 16 (D.L.R.).

⁶⁴ *Ibid.*, at pp. 356 (D.L.R.), 319 (N.S.R.).

⁶⁵ *Ibid.*, at pp. 357 (D.L.R.), 319-320 (N.S.R.).

⁶⁶ R.S.N.S. 1967, c. 48, s. 12.

the buyer of her right to redeem the goods upon payment of the outstanding balance.⁶⁷ In her view, this meant that the conditional buyer was not entitled to notice prior to repossession since "the Legislature has anticipated and spelt out the problem of the requirement of notice and although this legislative requirement does not make notice obligatory in advance of repossession (which would be my preference) it does provide for notice".⁶⁸ It is safe to say that the provincial legislatures never consciously addressed their minds to the desirability of notice prior to repossession. Nevertheless, the Chief Justice's conclusion is one that would be shared by lawyers acting for conditional sellers albeit on a broader ground. Their position could be expected to be that no notice prior to repossession was required at common law and that the confinement of the statutory requirement to notice after repossession merely *confirmed* the common law position. I return to this issue below.

The conclusion, I think, that can be drawn from Weatherston J.A.'s judgment in *Lister* and Glube C.J.T.D.'s reasoning in *Jim Landry* is that neither goes so far as to support McKinlay J.A.'s assertion of a rule of law requiring the creditor to give notice to the debtor where the credit is relying on a default clause which clearly dispenses with notice. Nevertheless, in all three cases (and in others I have not mentioned) we see a strong judicial urge to give the debtor the benefit of prior notice regardless of the source of the creditor's entitlement to payment.

So far we have only considered the position with respect to demand payment security agreements, including those containing default clauses. Do notice requirements also apply to term agreements where the debtor is obliged to make payments on fixed dates and the creditor is not entitled to require payment of the whole debt at his unfettered discretion? Here, one would have thought, there is a clear difference. The origin of the debtor's entitlement to a reasonable time was the judicial attempt to construe the meaning of the contractual requirement that the debtor must pay "on demand". If there is no demand payment clause but an agreement that the debtor will make payment or perform other obligations at stipulated times then only much judicial pounding and twisting could imply a term requiring the creditor to give notice before it was entitled to invoke its default remedies.

Another way to rationalize a natural reading of the security agreement is to say that term payment obligations substantially reduce the scope for a creditor's opportunistic behaviour⁶⁹ and that enforcement of the security

⁶⁷ This provision has a long history in Canadian conditional sales law and is, or was to be, found in most of the provincial acts. As previously noted, the concept has been carried over to the Personal Property Security Acts.

⁶⁸ *Supra*, footnote 61, at pp. 357 (D.L.R.), 319 (N.S.R.).

⁶⁹ However, it does not reduce it entirely. Many term payment agreements entitle the creditor to accelerate the balance of the debt and to enforce the security whenever

agreement is much less likely to catch the debtor unawares. At any rate this is how Anglo-Canadian conditional sales, hire-purchase and chattel mortgage law saw it for more than a century, and one searches the records in vain for any suggestion that the creditor was obliged to give notice to the debtor before exercising his default rights. It was precisely for this reason that consumer legislation in Canada and England was required to interpose restrictions on creditors' enforcement rights.⁷⁰

Unfortunately, all these important considerations were overlooked by the New Brunswick Appellate Division in *Roynat Limited v. Northern Meat Packers Ltd.*,⁷¹ when it had to decide whether the *Lister v. Dunlop* doctrine applied to term debentures. Plaintiff's counsel argued that it did not apply and pointed out that the Supreme Court was only dealing with the notice requirement in demand debentures. Speaking for the court, Stratton C.J.N.B. disagreed and thought that a contrary intention was indicated in the following passage in Estey J.'s judgment:⁷²

The rule has long been enunciated in *Massey v. Sladen* (1868), 4 Ex. 13 at p. 19, that the debtor must be given "some notice on which he might reasonably expect to be able to act". The application of this simple proposition will depend upon all the facts and circumstances in each case. Failure to give such reasonable notice places the debtor under economic, but none the less real duress, often as real as physical duress to the person, and no doubt explains the eagerness of the courts to construe debt-evidencing or creating documents as including in all cases the requirement of reasonable notice for payment.

With respect, Stratton C.J.N.B. was reading Estey J. out of context. Estey J. was only addressing himself to demand payment financing agreements. The agreement before the Supreme Court was of this type and all the cases cited by Estey J., including *Massey v. Sladen*, involved demand payment clauses. The question whether the debtor was entitled to reasonable time in term agreements was not before the Supreme Court and it is unconceivable that Estey J. meant to include them without saying so expressly. As a commercial lawyer of many years' experience, he must have known that a notice requirement had never previously been applied to term agreements unless the agreement so provided. Moreover, as the italicized passage in his judgment indicates, he was referring to earlier judicial

there is a default, however minor in character or short in duration, without giving the debtor an opportunity to cure the default.

⁷⁰ In Canada many of the restrictions had their origins during the Depression era and are still largely in force. For the details, see J.S. Ziegel, *Retail Instalment Sales Legislation: A Historical and Comparative Survey* (1962), 14 U.T.L.J. 143. For some typical current provisions, see Consumer Protection Act, R.S.O. 1980, c. 87, s. 23, and the Personal Property Security Act, 1989, *supra*, footnote 21, s. 66(2). In England, restrictions on the lessor's repossession rights were first introduced in the Hire-Purchase Act 1938. For the current provisions, see Consumer Credit Act 1974, ss. 76(1), 90(1), and R.M. Goode, *Consumer Credit Law* (1989), pp. 676 *et seq.*

⁷¹ *Supra*, footnote 2.

⁷² *Ibid.*, at pp. 143 (D.L.R.), 217-218 (N.B.R.), quoting *Lister v. Dunlop*, *supra*, footnote 2, at pp. 746 (S.C.R.), 16 (D.L.R.). (Emphasis added in Stratton C.J.N.B.'s judgment).

decisions construing, not ignoring, the parties' agreement. Neither of these tests is consistent with an intention to extend notice requirements to term agreements.

E. *Demand Debentures and the Personal Property Security Acts*

Personal property security legislation, based on Article 9 of the American Uniform Commercial Code, is in force in three provinces, Ontario, Manitoba and Saskatchewan, and in the Yukon Territory, and has been so for some time.⁷³ Alberta and British Columbia also adopted such legislation in 1988 and 1989 respectively.⁷⁴ These Acts are expected to be proclaimed in the fall of 1990. The Maritime Provinces also have expressed serious interest in adopting such legislation⁷⁵ so that it is not unreasonable to anticipate that all the common law provinces will operate under the new chattel security regime in the foreseeable future.

In view of these developments, it is important to determine what impact they will have on the enforceability of demand debentures. Unhappily the various Acts differ on many points of detail and sometimes on questions of substance. However, the conceptual structure of the legislation is the same and the Acts adopt a common, and largely codified, approach to the enforcement of a security interest. We may take as our starting point the provisions in Part 5 of the Ontario Act.⁷⁶

In a typical provision, section 62 of the Act provides: "Upon default under a security agreement, (a) the secured party has, unless otherwise agreed, the right to take possession of the collateral by any method permitted by law." "Default" is defined in section 1 as meaning "the failure to pay or otherwise perform the obligations secured when due or the occurrence of any event whereupon under the terms of the security agreement the security becomes unenforceable". Section 60 of the Act deals with privately appointed and court appointed receivers and provides, *inter alia*, (section 60(1)(a)) that nothing in the Act prevents the parties to a security agreement from agreeing that the secured party may appoint a receiver or receiver and manager and from determining the receiver's rights and duties by agreement. With the exception of section 60, these provisions mirror similar provisions in Part 5 of Article 9 of the American Uniform Commercial Code. They reflect a general philosophy that the parties should be free

⁷³ The Ontario Act is the oldest and was first adopted in 1967 although it was not proclaimed until 1976. A revised Ontario Act, the Personal Property Security Act, 1989, *supra*, footnote 21, was adopted in 1989 and came into force in October of that year.

⁷⁴ See, S.A. 1988, c. P.4.05 as am.; S.B.C. 1989, c. 36.

⁷⁵ See, J.S. Ziegel, *Personal Property Security Legislative Activity, 1966-87* (1989), 15 C.B.L.J. 108.

⁷⁶ *Supra*, footnote 21.

to negotiate their own security agreement,⁷⁷ and that once default has occurred no impediments should be placed on the secured party's right to take peaceful possession of the collateral, whether directly or through the receiver.

In terms of demand debentures and the secured party's right to enforce its security, the critical issue is whether default has occurred within the meaning of section 1. The definition has two limbs. The first is predicated on the debtor's failure to pay or perform an obligation "when due". The dueeness will be determined by the terms of the agreement, which in turn brings us back to *Lister v. Dunlop* and Canadian courts' construction of the meaning of demand payment clauses. *Prima facie* this allows little scope for the invocation of doctrines of public policy such as were apparently favoured by McKinlay J.A. in *Kavcar*. However, the possibility should not be entirely excluded. All the provincial Acts retain the principles of law and equity as supplementary rules if they are not inconsistent with the express provisions of the Act.⁷⁸ It is therefore open to the debtor to argue that a demand payment provision which does not require the secured party to give reasonable advance warning of its exercise is unconscionable. However, as previously suggested, in a commercial context and given the current state of Canadian law, this defence is difficult to substantiate.

The other limb of the definition of default lends itself less easily to judicial manipulation. The question here is whether an event has occurred making the security enforceable under the terms of the agreement. It should be a straightforward constructional issue and, once again, is incompatible with the public policy or reasonableness test seemingly favoured by McKinlay J.A. and other provincial courts as previously discussed.

To summarize our discussion to this point. Section 62 of the Ontario Act entitles the secured party to take possession of the collateral upon the debtor's fault. Whether there is default depends essentially on the terms of the security agreement. This approach is consistent with Estey J.'s reading of the common law position in *Lister v. Dunlop* but is inconsistent with the heavy glosses added by later courts and with the rule of law approach favoured by McKinlay J.A. However, this is not the end of the matter since other sections in Part 5 of the PPS Acts and related provisions also have some bearing on the courts' supervisory powers over the secured party's enforcement rights. The important provisions are the following.

⁷⁷ See, Ontario Act, s. 9(1), and UCC 9-201, first sentence. (Unless otherwise indicated, all Code references are to the 1978 Official Text). Section 9(1) reads:

(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.

⁷⁸ See, for example, Ontario Act, s. 72.

(1) *Supervisory Jurisdiction Over Receivers*

Section 60(2)(d) of the Ontario Act gives the court broad supervisory powers over the appointment and conduct of a receiver.⁷⁹ For present purposes the important provisions appear in paragraphs (a) and (d). Paragraph (a) empowers the court to remove, replace or discharge the receiver. It seems tolerably plain that the power does not restrict the secured party's entitlement to seize the collateral and to appoint a receiver on the debtor's default, and that it only comes into play *after* the receiver has been appointed. Paragraph (a) therefore has no bearing on the construction of the demand debenture and the amount of notice that must be given the debtor before the debtor is deemed to be in default. Paragraph (d) is more broadly worded but, in my view, leads to the same result. It empowers the court to make any order with respect to the receiver that it thinks fit "in the exercise of its general jurisdiction over a receiver or receiver and manager".⁸⁰ The opening flush of section 60(2) makes it clear that this power applies to all receivers however appointed. Even so, on its face the power is not triggered until a receiver has been appointed and therefore does not affect the construction of the debenture or authorize the court to enjoin the appointment of a receiver.

(2) *The Court's General Powers to Give Directions*

Under section 67(1) of the Ontario Act (which appears in Part VI and not Part V of the Act) the court is given a range of supervisory powers which are not restricted to receivers.⁸¹ The powers are the following. The court may:

- (a) make any order, including binding declarations of right and injunctive relief, that is necessary to ensure compliance with Part V, section 17 or sub-section 34(3) or 35(4);
- (b) give directions to any party regarding the exercise of the party's rights or the discharge of the party's obligations under Part V, section 17 or sub-section 34(3) or 35(4);
- (c) make any order necessary to determine questions of priority or entitlement in or to the collateral or its proceeds;
- (d) relieve any party from compliance with the requirements of Part V, section 17 or sub-section 34(3) or 35(4), but only on terms that are just for all parties concerned;

⁷⁹ To avoid needless repetition, "receiver" is used hereafter to include a receiver and manager.

⁸⁰ The same provision appears in the British Columbia Act, *supra*, footnote 74, s. 66(1).

⁸¹ Comparable and, to some extent, even broader powers appear in the British Columbia Act, *supra*, footnote 74, s. 63(2), and in the Saskatchewan Act, S.S. 1979-80, c. P-6.1, s. 63.

- (e) make any order necessary to ensure protection of the interests of any person in the collateral, but only on terms that are just for all parties concerned; and
- (f) make an order requiring a secured party to make good any default in connection with the secured party's custody, management or disposition of the collateral of the debtor or to relieve the secured party from any default on such terms as the court considers just, and to confirm any act of the secured party.

What bearing do these provisions have on a secured party's powers under a demand debenture? Only paragraphs (b) and (e) appear to be relevant and even they on a careful reading, it is suggested, do not authorize the court to rewrite the terms of the security agreement. Paragraph (b) only empowers the court to regulate the *exercise* of a party's rights under Part V of the Act (for example, the disposition of the collateral pursuant to section 63). This is an adjectival power and clearly is not broad enough to authorize the court to extend the period of notice required to be given to the debtor or to suspend the appointment of a receiver altogether. Paragraph (e) appears to be more open-ended, but this depends on how one construes the meaning of "to ensure protection of the interests of any person in the collateral". It is safe to postulate that what the drafters had in mind was the protection of the debtor's equity in the collateral or the rights of a subordinate secured party against conduct by the secured party that violates the Part V norms. "Interests" here must surely mean legal or equitable interests cognizable in a court of law, and the protection must be against misconduct by the secured or another party. It is true that the requirement that any order of the court "must be just for all parties concerned" implies a broad discretion in the exercise of the court's powers. However, there is no essential incompatibility between the exercise of the discretion and respect for the parties' legal rights.

Underlying the construction of all these provisions is the broader question of what function they were intended to serve? Were they designed to give the court a broad residuary power to relax the requirements of Part V and to protect the debtor against a harsh exercise of the secured party's rights or was their purpose a much more restricted one? This basic issue was addressed by the Saskatchewan Court of Appeal in an important decision, *Re Andrews and Mack Financial (Canada) Ltd.*⁸²

The secured party had repossessed the collateral (a truck) on the debtor's default. The debtor then obtained an order from the chambers judge pursuant to section 63 of the Saskatchewan Act⁸³ (Saskatchewan's counterpart to section 67 of the Ontario Act) setting aside the seizure and allowing the debtor to reinstate the agreement on making good the arrear in payments.

⁸² (1988), 46 D.L.R. (4th) 731, *sub nom.*, *Andrews v. Mack Financial (Canada) Ltd.*, [1988] 2 W.W.R. 747 (Sask. C.A.).

⁸³ *Supra*, footnote 81.

The question on appeal was whether section 63 permitted the chambers judge to make such an order. Although the Court of Appeal considered section 63 as an entirety, it appears that the debtor was relying particularly on the following powers in the section to justify the judge's order:

- (d) [to] stay enforcement of rights provided in this Part (sc. Part 5) or section 17, but only on terms that are just and reasonable for all parties concerned;
- (e) [to] make any order necessary to ensure protection of the interests of any person in the collateral.

It will be observed that paragraph (d) has no counterpart in section 67 of the Ontario Act.

Despite their apparent breadth the Court of Appeal was not willing to read these provisions as authorizing the setting aside of a lawful seizure. Speaking for the court, Vancise J.A. was firmly of the view that section 63 does not permit the court "to rewrite or change the *substance* of an agreement entered into between the parties".⁸⁴ He equally rejected the debtor's argument that section 63 created a scheme of debtor relief or consumer protection. He observed:⁸⁵

When Part V, which includes s. 63, is read in its entirety, it is apparent that an elaborate mandatory scheme has been constructed to ensure a commercially reasonable result when a security agreement is in default. Part V is designed to protect the interests of both the secured party and the debtor. To accede to the submission of the respondents would be to substitute a scheme based on concepts of consumer protection or debtor relief focussing primarily, if not exclusively, upon the debtor's right for a scheme intended to protect *both* parties, the creditor as well as the debtor. . . . It would amount to a scheme vesting a judge with unfettered discretion to decide whether or not contractual rights conferred upon a creditor should be altered to the latter's detriment. I am not prepared to accept that was the intention of the legislature.

The court's reasoning is persuasive and is even more appropriate for the Ontario Act than it is for the Saskatchewan and other Western provincial Acts. There is however an important inconsistency in Vancise J.A.'s reasoning. While he denied that section 63 empowered the court to rewrite or change the substance of the agreement, he conceded that the section gave the trial judge the right to stay proceedings, on conditions if necessary, "in order to protect the respective rights of the parties".⁸⁶ In his view, one of the conditions could be to give the debtor additional time to reinstate the contract. He contended that while this would amount to an alteration of the contract it would not amount to an alteration of the substance of the contract. Vancise J.A. is surely mistaken. Changing the terms of payment or obliging the secured party to accept reinstatement of the agreement after default surely involve substantive changes. And in any event should any distinction be drawn between substantive and non-substantive changes? A further difficulty is that section 62(2) of the

⁸⁴ *Supra*, footnote 82, at pp. 740 (D.L.R.), 756 (W.W.R.). (Emphasis in the original).

⁸⁵ *Ibid.*, at pp. 740 (D.L.R.), 757 (W.W.R.). (Emphasis in the original).

⁸⁶ *Ibid.*

Saskatchewan Act expressly permits the debtor to reinstate the agreement without the need for a court order. This suggests that whatever office sections 63(d) and (e) were intended to serve, changing the terms of the agreement was not one of them.⁸⁷

It remains to consider two other provisions in the provincial legislation which may have some bearing on the exercise of the secured party's rights.

(3) *Extension or Abridgment of Time*

Section 70 of the Ontario Act⁸⁸ empowers the court to extend or abridge the time for compliance on terms that the court considers just where the Act (other than in Parts III and IV and in other designated sections) prescribes a time for the performance of any act or thing. Section 70 may serve a valuable office under Part V where the debtor or secured party seeks relief from having to meet a time limit. However, it is difficult to see how it can be used by either party to restrict or extend the amount of notice required to be given under a demand debenture. This is because the notice requirement is either a contractual requirement (*Lister v. Dunlop*) or it arises by operation of law (*Kavcar*). In either event it is not a statutory requirement.

(4) *Good Faith Requirement*

This is the ace in the hole that will probably trouble secured parties most. There is no such requirement in the Ontario Act and, because of its controversial character, it was consciously omitted from the Uniform Act. However, a good faith requirement appears in the Saskatchewan Act⁸⁹ and it has been copied in the Alberta and British Columbia Acts.⁹⁰ Section 64(1) of the Saskatchewan Act reads:

(1).- All rights, duties or obligations arising under a security agreement, under this Act or under any other applicable law, shall be exercised or discharged in good faith and in a commercially reasonable manner.

Disturbingly, good faith is not defined so we are left to draw our own conclusion as to what it may mean. The mystery deepens because the good faith requirement does not appear in the report of the Saskatchewan Law Reform Commission recommending adoption of the Saskatchewan Act,⁹¹ and its meaning is not discussed in a subsequent handbook on the

⁸⁷ Curiously, s. 62(2) is nowhere mentioned in the court's judgment nor does the court discuss its relationship to s. 63.

⁸⁸ Formerly s. 63. *Cf.*, s. 71 of the B.C. Act, *supra*, footnote 74.

⁸⁹ *Supra*, footnote 81, s. 64(1).

⁹⁰ Alta.: *supra*, footnote 74, s. 66(1); B.C.: *supra*, footnote 74, s. 68(2).

⁹¹ Law Reform Commission of Saskatchewan, *Proposals for a Saskatchewan Personal Property Security Act* (July 1977).

Act published under the auspices of the Commission.⁹² Anglo-Canadian law does not have a general good faith doctrine for the exercise of contractual rights or the performance of contractual duties. A good faith requirement is of course a familiar ingredient, both in equity and by statute, for the acquisition of a purchaser for value status, but this has no bearing on the exercise of contractual rights.

The American Uniform Commercial Code (the "Code") does adopt a general good faith requirement, applicable to contracts governed by the Code and duties imposed by the Code.⁹³ Except where otherwise provided in the Code,⁹⁴ good faith is defined as meaning "honesty in fact in the conduct or transaction concerned".⁹⁵ Is this the definition the Saskatchewan legislature had in mind (assuming the legislature addressed its mind to the question at all, which seems unlikely)? Recommendations have been made by the Ontario Law Reform Commission⁹⁶ for the adoption of a broader standard of good faith in sales contract and general contractual relationships requiring the observance of reasonable standards of fair dealing as well as honesty in fact. However, since these recommendations only appeared after the enactment of the Saskatchewan Act, and in any event have not so far been implemented, they could scarcely have been in the legislature's contemplation.

Where does all this leave us or, more accurately, where does this leave a court that is asked to apply the good faith requirement in the Western provincial Acts to a demand debenture? The court has three alternatives. One is to deny any meaning to section 64(1) in the absence of a definition of good faith and other helpful indicia. Though justifiable, a court may be reluctant to adopt such an Olympian attitude and may therefore prefer to pursue the second or third alternatives. The second alternative is to embrace the Code's definition of honesty in fact. This would have the advantage of a respectable pedigree and consistency with the well-established meaning in equity and in statutory provisions protecting purchasers for value and in good faith. The third alternative would take the court a good deal further and would require the observance of reasonable standards of fair dealing. As has been seen, this construction also has

⁹² R.C.C. Cuming and R.J. Wood, *A Handbook on the Saskatchewan Personal Property Security Act*, Comment on s. 64(1), pp. 315-316 (Law Reform Commission of Saskatchewan, August 1987). Professor Cuming was the principal draftsman of the Saskatchewan Act.

⁹³ UCC 1-203: "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement."

⁹⁴ See, in particular, UCC 2-103(1)(b) defining good faith to mean, in the case of a merchant, honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.

⁹⁵ UCC 1-201(19).

⁹⁶ Ontario Law Reform Commission, *Report on Sale of Goods* (1979), Vol. 1, ch. 7(b), and draft bill, ss. 1.1(1)15 and 3.2, and *Report on Amendment of the Law of Contract* (1987), ch. 9.

respectable precedents. It accords with trends which some observers detect in recent Canadian decisions⁹⁷ and with what is a growing body of American jurisprudence on lenders' liability for unreasonable conduct.⁹⁸

How will either of these interpretations affect the lenders' rights under a demand debenture? If good faith merely means honesty in fact then the debtor would have to show that the lender was actuated by malice or vindictiveness in requiring repayment of the loan. This would be a heavy burden for the debtor to discharge and might also create difficult evidentiary problems where the lender was actuated by mixed motives, including the debtor's precarious financial position. What if the debtor only has to prove unreasonableness or lack of fair dealing on the lender's part (the third alternative)? What would it add to the requirement of reasonable notice under the *Lister v. Dunlop* doctrine? The answer is twofold. First, the requirement of fair dealing would not depend on the construction of the debenture; it would be imposed *ab extra*. Second, a fairness requirement would almost certainly go beyond the need to give reasonable notice to the debtor (although it would include it). It may well embrace the complaint that the lender had no good reason to require repayment of the loan and that the lender was acting arbitrarily or capriciously. It will be seen then that good faith in the sense of fair dealing generates a heavy penumbra of uncertainty, particularly if the factual question is left, as it often is left in the United States, to be decided by a lender hostile jury.

III. Where Do We Go From Here?

I hope I have succeeded in showing that the current Canadian law is both confusing and unsatisfactory.⁹⁹ Few aspects of the creditor's right to enforce its security are totally certain or the courts' reaction predictable. The court's judgment in *Kavcar* has measurably added to the uncertainty. *Lister v. Dunlop* established the debtor's right to reasonable notice before she was deemed to be in default under a demand payment agreement. However, subsequent case law has thrown into serious doubt the basis

⁹⁷ Such as *Lac Minerals Ltd. v. International Corona Resources Ltd.*, [1989] 2 S.C.R. 574, (1989), 61 D.L.R. (4th) 14. See Comment by P.D. Maddaugh (1990), 16 C.B.L.J. 198, and *cf.*, B.M. McLachlin, A New Morality in Business Law? (1990), 16 C.B.L.J. 319.

⁹⁸ For some of the abundant United States literature on the growing volume of case law see, D.R. Fischel, The Economics of Lender Liability (1989-90), 99 Yale L.J. 131; W.F. Ebke and J.R. Griffin, Lender Liability to Debtors: Toward a Conceptual Framework (1986-87), 40 Sw. L.J. 775; S.H. Hilfinger, *K.M.C. Co. v. Irving Trust Co.*: Discretionary Financing and the Implied Duty of Good Faith (1986-87), 81 Nw. U.L. Rev. 539; M. Snyderman, What's So Good About Good Faith? The Good Faith Performance Obligation in Commercial Lending (1988), 55 U. Chi. L. Rev. 1335.

⁹⁹ Though nothing remotely as alarming, it should be added, as mushrooming lender liability suits in the United States frequently resulting in multimillion dollar damage awards, including heavy punitive damages.

of the debtor's notice entitlement, how the amount of notice is to be determined in any particular case, whether it applies to default clauses and to creditors' enforcement rights that are already regulated by statute and, finally, whether the notice requirement also applies to term agreements.

The PPS legislation, as I have tried to show, does not resolve these uncertainties. If anything it adds to them because of the supervisory powers of uncertain scope vested in the courts, particularly in the Western provincial Acts, and more particularly because of the delphic requirement to act in good faith appearing in the Saskatchewan, Alberta and British Columbia Acts.

What can or should be done to clarify the position? Some may feel that I have exaggerated the difficulties and that secured creditors have little to fear so long as they give at least one day's notice before appointing a receiver. In my view, this optimism is not justified. McKinlay J.A. in *Kavcar* does not commit herself to a firm base line; the best we can say is that, following the British Columbia Court of Appeal's lead in *Whonnock Industries*,¹⁰⁰ she would accept seven days' notice as sufficient in (presumably) all cases and that even any notice may be dispensed with in appropriate cases. Such parameters are hardly the badge of certainty of a mature system of commercial law even if all the other questions discussed in this article were not left unresolved.

Another possibility would be to invite the Supreme Court to review the *Lister v. Dunlop* doctrine comprehensively and to provide detailed guidance as to its scope and basis, the minimum and maximum amount of notice required where the debtor is entitled to notice, and the applicability of the doctrine to non-demand payment clauses and agreements. The likelihood of the Supreme Court accepting the invitation at an early date is at best conjectural; the prospect of its obliging the commercial community by answering all of the enumerated questions even more so. Settling private law uncertainties does not rank high in the court's list of priorities.

Yet another possibility would be for creditors to revise their agreements to spell out specifically the amount of notice to which the debtor would be entitled in the case of demand payment clauses, and to exclude with equal clarity any requirement of notice in other cases, if this is what the creditor seeks. Unfortunately, this solution is no more promising than the first two. First, even the courts which accept the constructional approach have not hesitated to ignore even the clearest language. Second, as has been seen, *Kavcar* asserts that the debtor's right to notice is not consensual, or at any rate does not depend on the parties' agreement, but derives from a non-exclusionary rule of law. So long as this proposition remains good law, it cannot easily be neutralized by the drafter's art, no matter how skilfully deployed.

¹⁰⁰ *Supra*, footnote 2.

We are therefore driven to seek a statutory solution to the current conundrum, but of what kind? If creditors could have their way they would no doubt prefer a statutory affirmation of the English position. This would provide that, unless otherwise agreed, (1) where payment is due on demand the debtor shall only be entitled to so much time as is necessary to obtain the money from an existing facility, and (2) where there is default, that the secured party may proceed with enforcement of the security agreement without giving prior notice to the debtor.

If one were confident that the parties were bargaining from positions of approximately equal strength in even a majority of cases, one could accept this solution with equanimity. Business debtors could be left to look after themselves. But of course we know differently. Debtors may have a reasonable choice of financing agencies but they have almost no choice in the boiler plate contents of the credit agreement.¹⁰¹ For reasons that are not entirely clear, creditors do not compete to offer debtors the least onerous enforcement terms. It is no doubt this economic reality that explains Canadian courts' willingness to come to the debtors' aid, and that prompted Estey J. in *Lister v. Dunlop* to characterize a demand for payment under a demand payment clause as constituting a form of economic duress as painful in its impact as physical duress. There is a strong case, therefore, for entitling even a business debtor to some amount of notice before the guillotine falls.

But how much notice and in what circumstances? These questions are easier asked than answered. Notice should obviously be required in the paradigmatic case of demand payment clauses. Should it also be required in the case of default under term agreements and before the enforcement of default clauses in demand payment agreements? I would answer yes for two reasons. First, because the debtor's need for some degree of protection, for a measure of due process, is as real in the latter cases as it is in the case of demand payment clauses and, second, because although the debtor objectively knows in the case of term agreements that the creditor has the right to close down his business when even a single payment has been missed for a day or some other default has occurred, he has no means of knowing in advance whether the creditor will enforce its strict rights.

A related question is whether the notice requirement should be restricted to security agreements encompassing all or a substantial part of the debtor's assets (the type of agreement in which receivership provisions are most likely to be found), or whether the requirement should apply in all cases. Purchase money financiers and such like can be expected to argue that imposing a formal notice requirement is unnecessary because in practice the debtor will receive several warnings before the collateral is repossessed,

¹⁰¹ The frequency with which the same debenture clauses appear in the reported cases attests to this fact.

and that a notice requirement would only add to creditors' costs and encourage them to enforce their rights strictly. My own belief is that creditors' interests are best served by keeping the notice requirements as simple as possible and that no distinction should be drawn, quantitatively or qualitatively, between the volume and types of collateral. For the same reasons, I would not restrict the notice requirement to security agreements entitling the creditor to appoint a private receiver.

The question of how much notice the debtor should be entitled to is still more difficult. Since the object is to introduce greater certainty, a subjective test—how much time *this* particular debtor needs, assuming he is not insolvent—must be rejected. Nor do I think the period should be based on how much time a reasonably solvent debtor would need to refinance the debt since this period will always differ from case to case. Moreover, any such period must be balanced against the creditor's need to be protected against debtor's misconduct after notice of repayment has been given, and against precipitous declines in the value of the collateral. I would therefore select a period that is more than sufficient to enable the debtor to withdraw funds from an existing facility, or that is sufficient to allow him to re-open negotiations with the creditor or to begin serious discussions with a new financier, and that prepares him mentally for the worst case scenario if that should prove to be the case. A notice of between three and seven days would appear to meet these objectives adequately.¹⁰² I also see considerable merit in requiring demand payment security agreements involving credit facilities below \$100,000 to carry a conspicuous warning message alerting the debtor to the fact that the agreement entitles the creditor to demand payment at any time, whether or not the debtor is in default under any terms of the agreement, and subject only to such prior notice as may be prescribed by law.¹⁰³

I see no justification for requiring the creditor to seek the leave of a court before enforcing its security or appointing a receiver¹⁰⁴ since this would inevitably increase costs without corresponding benefits. It should be possible for the debtor to apply to a judge for an extension of time

¹⁰² This is less than the fifteen days' notice of the creditor's intention to appoint a receiver considered in the Report of the Advisory Committee on Bankruptcy and Insolvency, *op. cit.*, footnote 43, p. 4. The Committee's choice was overwhelmingly influenced by its desire to give the debtor sufficient time to launch a proposal under the proposed amendments to the Bankruptcy Act that would be binding on secured as well as unsecured creditors if approved by the requisite majority of each class of creditors. This raises an entirely new set of issues which lie beyond the purview of this article.

¹⁰³ Creditors may object to this form of paternalism but it is amply justified by debtors' well documented naïveté about the implications of demand payment clauses. The requirement of a warning notice has many precedents in provincial securities legislation dealing with prospectus disclosure requirements.

¹⁰⁴ This was another possibility considered by the Bankruptcy Advisory Committee, *op. cit.*, footnote 43, and is not germane to the present discussion for the same reasons as explained in footnote 102.

if he can make out a sufficiently strong case and the application can be heard expeditiously—preferably before the notice period has expired.¹⁰⁵ The creditor should also be entitled to seek an *ex parte* abridgment of the notice period if the full period would seriously prejudice its position. The notice requirement should also be dispensed with, without the necessity of a court order, if the creditor has *bona fide* grounds for believing that the debtor has engaged or is likely to engage in misconduct once he is made aware of the creditor's intentions or that the collateral will decline quickly in value unless the creditor can take prompt possession and make arrangements for its disposition.¹⁰⁶

One point needs to be emphasized. This article is concerned with the enforcement of debentures outside bankruptcy and it examines the *Lister v. Dunlop* doctrine and its sequelae from the point of view of the parties to the agreement. I appreciate that the debtor's other creditors also have a close interest in these questions, particularly if the debtor's business can be rescued from bankruptcy with the aid of a plan or reorganization or compromise arrangement. This article is not concerned with these wider issues, which are not limited to the enforcement of demand debentures.

IV. Assessing Damages

If a statutory solution is adopted, then it should reduce substantially the volume of litigation though it is unlikely to eliminate it altogether. In any event, given government priorities, early legislation is unlikely so that creditors will continue to face the prospect of being sued for the foreseeable future if they fail to give notice before appointing a receiver or fail to give what a court, with the benefit of hindsight, may deem to be insufficient notice. For all these reasons both parties¹⁰⁷ will want to know what principles

¹⁰⁵ Section 70 of the Ontario Personal Property Security Act 1989, *supra*, footnote 21, confers on the District Court the power to abridge or extend the time for the performance of any act required to be done under the Act with important prescribed exceptions. The power appears to be broad enough to encompass applications under Part 5 of the Act, including applications relating to a creditor's statutory notice to proceed with enforcement of the security agreement.

¹⁰⁶ *Cf.*, s. 63(7) of the Ontario Personal Property Security Act, 1989, *ibid.* This dispenses, *inter alia*, with the creditor's need to serve a notice *after* the collateral has been seized where (a) the collateral is perishable; (b) the secured party believes on reasonable grounds that the collateral will decline speedily in value; or (d) for any reason not otherwise provided in subsection 7, if the District Court is satisfied on an *ex parte* application that a notice is not required. See *Lloyds Bank v. Transfirst Inc.* (1990), 71 O.R. (2d) 481 (Craig J.). I would not dispense with the need for notice because the debtor is insolvent or has gone into bankruptcy as this is precisely the situation in which the debtor or his representative needs time to review the situation. Moreover, in Canada a secured creditor has little to fear from bankruptcy since the Bankruptcy Act is very solicitous of secured creditors' interests.

¹⁰⁷ And debtors' guarantors since they will want to know to what extent their liability will be reduced or even eliminated as a result of the creditor's wrongful action. See, *Bank of Nova Scotia v. Ham*, *supra*, footnote 2.

will govern the assessment of damages. Fortunately, litigants now have the benefit of Morden J.A.'s superb judgment on the question in *R.E. Lister Ltd. v. Dayton Tire Canada Ltd.*,¹⁰⁸ though it does not deal with some important aspects of the problem.

Debtors habitually sue creditors in trespass as well as in conversion for wrongful seizure of the debtor's business. There is no recent case, however, in which the court has awarded separate damages under each of these heads—in fact the issue is not even discussed—and the judgments usually proceed as if there were only a claim for conversion. No doubt this is because it is felt that the two claims overlap and that damages for conversion will adequately compensate the debtor. In the following discussion I will proceed on the same basis.

As in the case of most tort claims, a damage award in conversion is intended, so far as possible, to put the plaintiff in the same position as if the tort had not occurred, subject to the usual rules of causation and remoteness and the plaintiff's duty to mitigate its damages. Assuming that the creditor has disposed of the assets after seizure and that the debtor's business has collapsed, this will normally mean that the debtor will be entitled to claim the higher of the value of the lost business or of the assets that have been disposed of.¹⁰⁹

Before addressing ourselves to the question of how these valuations are made, some attention must be paid to the important issues of causation and the debtor's duty to mitigate its damages. They have received surprisingly scant attention in the reported cases. The issue of causation will arise if the creditor can show that even if the debtor had been given more time she would still not have been able to raise the money or to refinance the debt. It will then be argued that the real cause of the debtor's misfortune was the insolvent condition of the debtor's business, and that the debtor is only entitled to nominal damages. McKinlay J.A. recognized the validity of this line of reasoning when she observed in *Kavcar*¹¹⁰ that while the debtor's impecuniosity would not be an excuse for the creditor's failure to give the debtor a reasonable amount of time unless the creditor could prove that this was the reason for the short notice, it may only justify the awarding of nominal damages where more time would not have availed the debtor.

¹⁰⁸ *Supra*, footnote 2.

¹⁰⁹ There is little discussion in the seizure cases of the proper valuation date, the dates chosen being usually the time of entry into possession by the receiver (for valuing the lost business) and the market price at the time of their disposition (for valuing the assets). It is not clear whether the debtor is limited to these dates if the business or the assets have appreciated in value thereafter. The leading discussion of the relevant issues now appears in *Asamera Oil Corp. Ltd. v. Sea Oil and General Corp.*, [1979] 1 S.C.R. 633, (1978), 89 D.L.R. (3d) 1.

¹¹⁰ *Supra*, footnote 1, at pp. 291 (D.L.R.), 238 (O.R.).

Since the unprofitability of the debtor's business is a common reason for the creditor's demand for payment, the result may seem unduly harsh. The debtor may argue that a creditor who wrongfully seizes the debtor's business should not be allowed to contend that the business would have come to grief in any event. The answer must surely be that the function of a damage award is to compensate the debtor for his actual loss, not to punish the creditor for its mistake. If the creditor has acted maliciously or in a high handed manner, this can be addressed separately in a claim for punitive damages.

It is not as easy as might be supposed for a creditor to prove that the business would have collapsed anyway. In *Kavcar*, for example, the receiver waited for six weeks before starting to dispose of the assets. Expert evidence was called to show that the business had no going concern value. Nevertheless, the trial judge was still not persuaded "that Kavcar would have been unable to raise the funds if a reasonable time had been given".¹¹¹ The Court of Appeal refused to interfere with this finding. *Lister v. Dayton Tire Canada Ltd.*¹¹² produced a still more surprising result. Lister admitted that its franchise with Dunlop was unprofitable and that it would have been quite happy to terminate it. On a reference from the trial judge to assess damages, the Master accepted Lister's evidence that, had it not been for Dunlop's appointment of the receiver and the receiver's seizure of the business, Lister would have been able to start up a new and profitable Goodrich franchise at a new location. This optimism seems puzzling since at the time of the receiver's seizure \$127,855.41 was owing to Dunlop and, according to the Master's own finding, Lister's assets were only worth \$126,397.13.¹¹³

One wonders therefore where Lister would have found the money to start a new venture which would have required a substantial infusion of new funds, particularly since after the seizure Mr. and Mrs. Lister were forced to give Dunlop a mortgage on their own property to secure their personal guarantees to Dunlop. Despite these facts the Master had no hesitation in finding that, but for the seizure, the debtor corporation would have had a bright future, and he allowed substantial damages (\$300,000) for loss of profits from Lister's prospective franchise with Goodrich. One important feature that emerges from these and other cases is that, in determining the debtor corporation's capacity to respond to a demand for payment, the courts will take into consideration the resources of the owners of the corporation as well as the financial position of the corporation itself.

¹¹¹ *Ibid.*, at pp. 291 (D.L.R.), 239 (O.R.).

¹¹² *Supra*, footnote 2.

¹¹³ *Ibid.*, at p. 95. I am very grateful to Lerner and Associates, solicitors for Dunlop on the appeal from the Master's decision, for providing me with a copy of the Appeal Book containing Master McBride's Reasons for Decision of December 16, 1983.

Like the issue of the proximate cause of the debtor's financial loss, the cases also pay little attention to the debtor's duty to mitigate its damages. There is no reason in principle why the duty to mitigate should not also apply where the debtor's assets have been seized. It has been applied in other conversion cases.¹¹⁴ Of course, there may be argument as to what constitutes reasonable mitigation. If a creditor has behaved in an arrogant and high handed manner one cannot expect the debtor to rush in to pay off the indebtedness so as to reduce the creditor's damage liability. The debtor should not be entitled, however, to ignore a *bona fide* offer from the creditor, such as was apparently made in *Kavcar*, to withdraw the receiver upon payment of the amount owing, on the grounds that it is too late to undo the damage that has been done. *Payzu Ltd. v. Saunders*,¹¹⁵ a leading English case, clearly shows that the debtor cannot refuse arbitrarily to deal with the creditor even where the creditor has wrongfully repudiated the contract.

It seems that the debtor's duty to mitigate impales him on the horns of a dilemma: if the debtor insists he lacks the funds to pay off the creditor and cannot raise them elsewhere, the creditor will argue this proves that the debtor's damages are only nominal; if the debtor contends that adequate notice would have enable him to refinance the debt then he must also explain why he failed to continue with his efforts even after the creditor's seizure.

Returning now to the question of valuations, the debtor can sue either for the value of the business as a going concern or for the value of the assets. He cannot do both because this would amount to double counting of losses.¹¹⁶ If the business is solvent the going concern value should yield a higher figure than the asset value, but putting a value on a closely held corporation is particularly speculative and involves many imponderables.¹¹⁷ In *Lister v. Dayton Tire Canada Ltd.*,¹¹⁸ the Court of Appeal held that the Master had erred in valuing Lister Ltd.'s lost business opportunity by multiplying the prospective net annual profit by the arbitrary figure of thirty years. The correct approach, in Morden J.A.'s view, was to capitalize the future anticipated income of Lister's business by using an appropriate multiplier for the net annual profit. Using this approach, Morden J.A. obtained a going concern value (\$146,000) which was less than half the damages (\$300,000) assessed by the Master under this head.

¹¹⁴ See, *Asamera Oil Corp. v. Sea Oil and General Corp.*, *supra*, footnote 109.

¹¹⁵ [1919] 2 K.B. 581 (K.B.D., C.A.); S.M. Waddams, *The Law of Damages* (1983), para. 1206.

¹¹⁶ *Lister v. Dayton Tire Canada Ltd.*, *supra*, footnote 2, at pp. 106-107. Cf. *R.G. McLean Ltd. v. Can. Vickers Ltd.* (1970), 15 D.L.R. (3d) 15, [1971] 1 O.R. 207 (Ont. C.A.).

¹¹⁷ See, generally, I.R. Campbell, *The Principles and Practice of Business Valuations* (1975).

¹¹⁸ *Supra*, footnote 2, at pp. 107-109.

Valuing the debtor's assets has also given rise to differences of opinion. If the receiver has disposed of them the creditor will want to argue that the net sales price represents the fair value of the assets. The court may be persuaded, however, that a forced sale cannot be expected to realize the best price, especially if the debtor adduces evidence of a higher offer having been made for the same assets.¹¹⁹ *Prima facie* the measure of damages for the conversion of the assets is their market value at the time and place of conversion.¹²⁰ Anomalously, in *Lister v. Dayton Tire Canada Ltd.*,¹²¹ the Master allowed the debtor the acquisition cost of the inventory even though, curiously, the debtor itself had argued in favour of the market value, which was lower than the best estimate of the market value at the time of conversion. Morden J.A.'s reasoning, affirming the Master's approach, is difficult to follow—probably because some relevant facts are missing from his judgment.¹²² It seems best to assume that his acquiescence in the adoption of the acquisition cost test turned on the particular facts of the case, and that he did not mean to lay down the untenable proposition that the debtor is always entitled to be credited with the higher of the acquisition cost or the market value of the inventory. Unfortunately, in *Kavcar*,¹²³ McKinlay J.A. read Morden J.A.'s judgment more broadly and, with no discussion of the issue, ordered that the plaintiff's inventory should be valued at cost.

Finally, there is the question of when a debtor may hope to recover punitive damages. Claims for punitive damages are common but, if the reported cases are a reliable guide, are very sparingly granted.¹²⁴ Fortunately for creditors, Canadian courts have resisted the temptation, in the absence of aggravating circumstances, to equate unlawful seizure of the debtor's

¹¹⁹ As happened, for example, in *Roynat v. Northern Meat Packers*, *supra*, footnote 2, at pp. 145 (D.L.R.), 220 (N.B.R.).

¹²⁰ *Ibid.*, at pp. 144 (D.L.R.), 219 (N.B.R.), citing Waddams, *op. cit.*, footnote 115, p. 57, para. 99, and H. McGregor, *McGregor on Damages* (14th ed., 1980), pp. 717-719.

¹²¹ *Supra*, footnote 2, at pp. 112-113.

¹²² It appears from the Master's Reasons that the market price at the time of seizure was less than the acquisition price because the inventory supplied by Dunlop was of inferior quality. After the seizure Dunlop took back the remaining inventory and credited Lister with the market value. The Master found this was a fair value. Nevertheless, he gave Lister the benefit of the acquisition cost on the ground that Dunlop should not be allowed to profit from its own wrongdoing; *sed quaere*.

¹²³ *Supra*, footnote 1, at pp. 293 (D.L.R.), 241 (O.R.).

¹²⁴ According to Professors Vidmar and Feldthusen, an award for punitive damages is very much the exception in tort cases brought in Ontario. See, Neil Vidmar and Bruce Feldthusen, *Exemplary Damage Claims in Ontario: An Empirical Profile*, Appendix to B. Feldthusen, *Recent Developments in the Canadian Law of Punitive Damages* (1990), 16 C.B.L.J. 241. The 2nd through 6th Canadian Abridgment Ann. Supp., sub. "Damages", digest only two reported seizure cases in which punitive damages were awarded for wrongful seizure. *Lister v. Dunlop* was one, and *Clunie Enterprises Ltd. v. Melfort Credit Union Ltd.*, *supra*, footnote 2, was the other.

business with conduct justifying the imposition of punitive damages. Canadian creditors have also not had to contend with multimillion dollar jury awards as have American creditors.¹²⁵ This does not mean that Canadian creditors can afford to be complacent, for everything will turn on the trial judge's all important findings of fact. Many epithets have been used to describe the type of conduct warranting the imposition of punitive damages, including such terms as "malicious", "high-handed", "arbitrary", "oppressive", "deliberate" and "callous";¹²⁶ all of them include an element of wilfulness or at least recklessness. Negligence alone is not sufficient. Nor, as Morden J.A. pointed out,¹²⁷ can a creditor be faulted for following its solicitor's advice. On the other hand, the creditor may be expected to be held accountable for the receiver's conduct even though debenture documents regularly provide that the receiver shall be deemed to be the debtor's agent.¹²⁸

Where punitive damages have been allowed they have not been exorbitant. In *Lister Ltd. v. Dayton Tire Canada Ltd.*,¹²⁹ for example, the Master awarded each of the plaintiffs \$35,000 punitive damages, or about five per cent of the total award to R.E. Lister Ltd., and ten per cent of the award to R.E. Lister personally. On appeal, the punitive damages to R.E. Lister Ltd. were reduced from \$35,000 to \$20,000 and the aggregate damages were reduced from \$611,000 to \$146,000. As a result the ratio of punitive damages to total damages jumped to about thirteen per cent. There is no evidence however that the courts consciously think in percentage terms; the evidence rather points to punitive damage awards calculated in absolute terms to indicate the court's disapproval of the creditor's conduct.¹³⁰ It must be strongly emphasized that the cases are much too small in number to form the basis for any firm conclusions.

¹²⁵ *Supra*, footnote 99.

¹²⁶ *Roynat Ltd. v. Northern Meat Packers Ltd.*, *supra*, footnote 2, at pp. 145 (D.L.R.), 220 (N.B.R.), citing Waddams, *op. cit.*, footnote 115, p. 571, para. 998.

¹²⁷ *Lister Ltd. v. Dayton Tire Canada Ltd.*, *supra*, footnote 2, at p. 122.

¹²⁸ See, *inter alia*, *Peat Marwick Ltd. v. Consumers' Gas Co.* (1980), 113 D.L.R. (3d) 754, 29 O.R. (2d) 336 (Ont. C.A.); *Sperry Inc. v. Canadian Imperial Bank of Commerce* (1985), 17 D.L.R. (4th) 236, 4 P.P.S.A.C. 314 (Ont. C.A.). The effect of such agency clauses on the creditor's liability for the receiver's conduct does not appear to have been considered in the Canadian case law. It is safe to assume however that courts will strive mightily to find that it was not meant to apply to an improper appointment and seizure of assets and, if the *Kavcar* approach is followed, that such an exculpatory clause is unenforceable.

¹²⁹ *Supra*, footnote 2, at pp. 121-123.

¹³⁰ This impression is supported by the results in *Clunie Enterprises Ltd. v. Melfort Credit Union Limited*, *supra*, footnote 2. Gerein J. assessed general damages at \$1,175 and punitive damages at \$5,000. The general damages were so low because the receiver was able to sell the business for substantially the same price as an offer that had been made to the debtor before the seizure. The creditor's conduct was particularly arbitrary and high-handed, and understandably attracted the trial judge's strong censure.