PERSONAL PROPERTY SECURITY
AND BANKRUPTCY:
THERE IS NO WAR!

A Reply to Roman and Sweatman

Jacob S. Ziegel*

In their article in the March 1992 issue of the Canadian Bar Review,1 Andrew Roman and Jasmine Sweatman make the bold and very dogmatic claim that section 20(1)(b) of the Ontario Personal Property Security Act2 and its counterpart in the other provincial personal property security acts purporting to invalidate or subordinate an unperfected security interest to the interest of a trustee in bankruptcy is ultra vires and beyond the constitutional competence of the provinces.3 In my opinion, their argument is untenable.

The authors make their claim despite the admission that the argument (first raised in an article by Mr. Peltomaa)4 has been rejected in an unbroken line of recent Ontario and Saskatchewan decisions of first instance and, in one case,5 at the appellate level. To this list should now be added

* Jacob S. Ziegel, of the Faculty of Law, University of Toronto, Toronto, Ontario.


2 R.S.O. 1990, c. P.10. Section 20(1)(b) reads:
   Except as provided in subsection (3), until perfected, a security interest . . .
   (b) in collateral is not effective against a person who represents the creditors of the debtor, including an assignee for the benefit of creditors and a trustee in bankruptcy . . .

3 The authors note the difference in wording between s. 20(1)(b) of the 1989 Act (now re-enacted in R.S.O. 1990) and s. 22(1)(a)(iii) of the old Act. They find a sinister reason for it and allege that it was "[an] attempt . . . to make the 1989 version cosmetically better, or less overtly ultra vires . . ."; loc. cit., footnote 1, at p. 81, n. 9. They are badly mistaken. The change was made for technical reasons which turn on the dual status of a trustee. They are explained in Report of the Minister's Advisory Committee on the Personal Property Security Act (Toronto, 1984), pp. 41-42, and were inspired by the decision in International Harvester Credit Corp. v. Touche Ross Ltd. (1986), 30 D.L.R. (4th) 387, [1986] 6 W.W.R. 161, 6 P.P.S.A.C. 138 (Sask. C.A.).


Fairley J.'s decision in *Re Haasen*, which was rendered after the publication of the article. Farley J., in a comprehensive judgment, fully endorsed Austin J.'s reasoning in *Re Hannah*, which is discussed in the article. Mr. Roman appeared as co-counsel for the respondent in *Re Haasen* and presumably Ms. Sweatman also played a role in the preparation of the respondent's argument on the constitutional issues. One may be forgiven therefore for the suggestion that their approach to the issues was not wholly impartial.

However, I will ignore this factor for the purposes of this reply and deal with their arguments on their own merits. Let me say at once that I fully agree with the earlier decisions and that, from a policy as well as the constitutional perspectives, I would be deeply disturbed if the authors' argument were to prevail. It may be that as a commercial lawyer, and as one who has been closely connected with the evolution of personal property security legislation in Canada, my mind is clouded in the opposite direction. I am happy to let the reader make up his or her own mind after I have presented my criticisms of the authors' thesis.

**Basis of Authors' Argument**

Roman and Sweatman rely primarily on the “quartet” of Supreme Court of Canada decisions in *Deputy Minister of Revenue v. Rainville*, *Deloitte Haskins and Sells Limited v. Workers' Compensation Board*, *Federal Business Development Bank v. Commission de la Santé et de la Sécurité du Travail*, and *British Columbia v. Henfrey Samson Belair Ltd.* to support their argument. I have no quarrel with the general conclusion which they draw from these decisions: that it is not competent for the provinces to change the distributional rules in section 136(1) of the Bankruptcy and Insolvency Act or to confer secured creditor status on a class of creditors not entitled to it under the Act. My difficulty is to understand how section 20(1)(b) of the Ontario Personal Property Security

---

7 [1988], 8 P.P.S.A.C. 181 (Ont. H.C.).
8 Mr. Roman also appeared as senior counsel in an earlier unreported case, *Re Riverview Dodge Chrysler Ltd.*, S.C.O. Bkcy. No. 043415 (1989), in which the same constitutional issues were raised. However, the bankruptcy judge found it unnecessary to address the issues. I am indebted to Hart Schwartz, a counsel in the Ontario Ministry of the Attorney General, for this and other information relating to the case in which Mr. Schwartz appeared on behalf of the Ontario government.
13 The title of the Bankruptcy Act was changed as part of the important package of amendments adopted by Parliament in Bill C-22 in June 1992. See S.C. 1992, c. 27, s. 2.
Act violates these principles and the relevance of the Supreme Court decisions in determining the validity of section 20(1)(b).

The authors’ reasoning appears to be that section 136(1) of the Bankruptcy and Insolvency Act confers an unqualified and unsullied priority on secured creditors’ claims in bankruptcy and that section 20(1)(b) interferes with this status by obliging secured creditors to comply with the perfection requirements of the provincial statutes. The analogy with the Supreme Court decisions seems to be this. In Rainville, Deloitte Haskins and Federal Business Development Bank the court struck down provincial attempts to change the characterization of Crown claims in section 136(1); similarly, in Henfrey, the court repelled British Columbia’s effort to extend the trust exception in section 67(2)(a) of the Bankruptcy and Insolvency Act to a relationship which did not satisfy the common law requirements of a trust. Section 20(1)(b) of the Ontario Act, we are to infer, is analogous because it too represents an improper attempt to change the federal Act, in this case by diluting the meaning of secured creditor.

**False Analogy**

In my view, the analogy is a false one. The fallacy lies in the authors’ assumption that imposing perfection requirements changes the character of secured credit or interferes with Parliament’s intention in putting the claims of secured creditors at the top of the distributional list. I believe the available evidence all points in the opposite direction.

“Secured creditor” is defined in section 2 of the Bankruptcy and Insolvency Act. The list includes various types of consensual and non-consensual security interests known to the common law and civil law. However, to understand any of the terms we need to invoke the relevant bodies of civil law, not only those peculiar to security transactions but those arising from general contract principles as well. This is no doubt one of the reasons why section 72(1) of the Bankruptcy and Insolvency Act preserves the substantive provisions of any other law or statute relating to property or civil rights that are not in conflict with it, although there are also other reasons. Even if section 72(1) did not exist the courts would be obliged to fall back on provincial law to interpret and give meaning to concepts and expressions used throughout the Bankruptcy and Insolvency Act.

Let me illustrate. Section 2 refers to a person “holding a mortgage”. “Mortgage” is a technical common law expression. Can there be any doubt that in case of dispute the tribunal would have to examine the relevant corpus of provincial law to determine whether its requirements had been

---

14 Some of the expressions are ambiguous but this complication need not distract us.

15 Or foreign law if, according to conflict of laws principles, the transaction was governed by non-Canadian law.
met for a valid mortgage—with respect to form, the parties’ capacity to enter into the agreement, whether there was an agreement to give security, the permissible scope of the agreement, the right of a secured party to sue for a deficiency after reposition and/or sale of the collateral and similar everyday questions—as well as determination of questions of priority where there is more than one mortgage or a conflict between a mortgage and some other type of security interest against the same collateral? Some of the answers will turn on common law principles but statutory rules will play an important part in almost all cases. In the case of chattel security agreements, statutory law will play a dominant role in those jurisdictions that have adopted Personal Property Security legislation.

Perfection Requirements: Origins and Rationales

I assume that Roman and Sweatman would agree with me about the need to interpret the meaning of secured creditor in section 136(1) against this underpinning of provincial law. Nevertheless, they are adamantly

---

16 Cf., Ontario Personal Property Security Act, supra, footnote 2, s. 11(2) (a security interest does not attach and is not enforceable against a third party unless inter alia the debtor has signed a security agreement that contains a description of the collateral sufficient to identify it).


19 The common law did not recognize a chattel mortgage on after-acquired property unless the mortgage was confirmed after the debtor’s acquisition of the property, but Equity did under the doctrine of Holroyd v. Marshall (1861), 11 E.R. 999 (H.L.). The equitable approach is adopted in the Ontario Personal Property Security Act, supra, footnote 2, s. 12(1), but there are important restrictions with respect to future crops and after-acquired consumer goods: s. 12(2).


21 The common law priority rules are complex and turn on the character of the collateral and on whether the security interest is legal or equitable in character. Part III of the Ontario Personal Property Security replaces these rules with a considerably simpler and uniform set of provisions.

opposed to including compliance with perfection requirements (federal as well as provincial?) as an admissible precondition to achieving secured creditor status. Is this distinction justified and if so, on what grounds? 23 Could one argue that perfection requirements are so alien to the purposes of section 136(1) and the elevated status it confers on secured creditors vis-à-vis preferred creditors that Parliament could not have intended them to apply? A thumbnail sketch of the origins and purposes of perfection requirements will help us find the answer to both questions. In my opinion, it is a resounding no.

The common law’s aversion to secret liens and other forms of covert transfer of title not accompanied by possession has a long history. Lord Coke stigmatized secret transfers as a badge of fraud24 and the first legislation on fraudulent conveyances25 dates from the same period. Until the nineteenth century it remained unsettled whether a chattel mortgage (or bill of sale as it used to be called) not accompanied by a change in possession was presumptively fraudulent. The issue was resolved in the mortgagee’s favour,26 but not for long. The first registration requirements for bills of sale and chattel mortgages were introduced in Ontario in 1849.27 By the turn of the century they were a familiar feature in most if not all of common law Canada. Their commonly accepted purpose was to prevent mortgagors from obtaining fictitious credit on the strength of possession of chattels which they had mortgaged and generally to protect third parties in dealings with the mortgagor.28

As new types of non-possessory security devices became popular registration requirements were extended to them as well—first to conditional sales, then to assignments of book debts and, in the 1930s, to secured bonds

23 I proceed from the premise adopted in all the recent decisions, supra, footnotes 5-7, and accepted by Roman and Sweatman, that the Personal Property Security legislation is not discriminatory and that trustees in bankruptcy are only one of several classes of person protected against unperfected security interests.
24 Twyne’s Case (1601), 3 Co. Rep. 80b, 76 E.R. 809 (Star Chamber).
25 13 Eliz., c. 5 (1570).
26 In the United States, chattel mortgages not accompanied by a transfer in possession were regarded as conclusively fraudulent until well into the 18th century, and even the adoption of registration legislation did not wholly legitimate them. See Grant Gilmore, Security Interests in Personal Property (1965), vol. I, para. 2.1-2.2.
and debentures issued by corporations. In short, by the time of the adoption of the Canadian Bankruptcy Act in 1919, registration requirements for chattel security agreements were a well understood concept and widely approved of by the business community. Not surprisingly, therefore, the first uniform act in the commercial sphere to which the newly created Conference of Commissioners on Uniformity of Legislation in Canada addressed its attention was the Uniform Conditional Sales Act. It and other chattel security legislation continued to occupy much of the Conference’s attention in the interwar period and beyond.

Nor were the provinces alone in their preoccupation with the evils of secret liens. There was “growing judicial and public criticism” of the lack of publicity surrounding the liens which the banks were authorized to take under the Bank Act. The response was the enactment by Parliament of registration requirements in 1923 which survive to this day. Section 427(4) of the current Bank Act provides that an assignment of security to a bank is “void” against creditors of the debtor giving the security and against subsequent purchasers or mortgagees acting in good faith.

Even more telling is section 94 of the Bankruptcy and Insolvency Act, which is one of a series of sections dealing with voidable settlements and preferences. Section 94(1) avoids an assignment of book debts that have not been paid at the date of the assignor’s bankruptcy. According to subsection (2), the voidness rule does not apply to an assignment that is registered pursuant to provincial legislation “if the assignment is valid” in

---

29 The sequence was different in the provinces that adopted a British style Companies Act requiring the registration of company charges with the Registrar of Companies. These requirements were introduced in England in 1907 and were copied in Canada. Separate legislation covering the registration of corporate securities was deemed necessary as a result of the majority holding in Gordon Mackay Limited v. Laroque, supra, footnote 27, that Ontario’s Bills of Sale Act did not cover fixed and floating charges.


33 “Creditors” is not defined and is an expression that also appears in the earlier provincial chattel mortgage legislation. There was considerable difference of judicial opinion in the interwar period about whether a trustee in bankruptcy or a liquidator represented general creditors since this was not made clear in the Bankruptcy Act or the Winding Up Act. The majority opinion was that they did and that they were entitled to impeach unperfected security agreements. See, for example, Re Rinn, [1923] 3 D.L.R. 986, [1923] 1 W.W.R. 1190 (Man. C.A.) (reviewing earlier authorities); Re Crossen Metal Works Ltd. (1920), 53 D.L.R. 341, [1920] 3 W.W.R. 197 (Man. C.A.), and, for a decision under the personal property security legislation, Touche Ross Ltd. v. Paccar Financial Services Ltd., supra, footnote 5.
accordance with provincial law. Section 94 was first adopted in 1919\textsuperscript{34} and was inspired by a similar provision in the British Bankruptcy Act. The section was intended to close an important gap in the provincial registration laws and had the desired effect. The provinces hastened to adopt assignment of book debts legislation and, in 1928, the Uniformity Commissioners promulgated a uniform Act on the subject.\textsuperscript{35} Here then we have a striking example of the federal government taking the initiative in stimulating the provinces to extend the scope of perfection requirements.

The conclusion which emerges from this overview is very clear. Perfection requirements have been an integral part of provincial chattel security law for more than a century and of federal law for about seventy years. Had the drafters of section 136(1) been asked what types of secured creditors they had in mind, we are entirely safe in assuming they would have answered—those creditors whose security complies with the applicable provincial or federal or other proper law and, in particular, with any relevant perfection requirements.

The answer is confirmed by the opening words of section 136(1), “Subject to the rights of secured creditors . . .”. How are those rights (and obligations) to be determined? Since the Bankruptcy Act does not spell them out the reply must surely be: by consulting the law that gave them birth, and that law, in the absence of conflicting federal prescriptions, also determines what conditions and restrictions are imposed on the recognition and enforceability of the security interest. This is how lawyers and judges for several generations have perceived the relationship between provincial law and the Bankruptcy Act, so much so that the first reported challenge\textsuperscript{36} to the validity of the provincial perfection requirements did not occur until 1988.

A different conclusion would have very mischievous consequences. It would nullify an important feature of the provincial chattel security Acts without, ironically, conferring an appreciable benefit on secured parties. Which secured creditor would run the risk of not meeting the provincial perfection requirements in the hope that the defect would not come to light unless and until the debtor became bankrupt?

\textit{The Lessons of Bill C-22.}

If additional evidence were needed about how Parliament views the contemporary relationship between classes of creditors and Crown liens and deemed trusts for unpaid taxes and deductions, it is to be found in the amendments to the Bankruptcy and Insolvency Act adopted in June of

\textsuperscript{34} S.C. 1919, c. 36, s. 30.


\textsuperscript{36} \textit{Re Hannah}, supra, footnote 7.
The following features are particularly illuminating. Section 67(2) abolishes deemed trusts but carves out critically important exceptions for monies required to be deducted or withheld under the Income Tax Act (sections 227(4) and (5)), the Canada Pension Plan (section 23(3) and (4)), the Unemployment Insurance Act (sections 57(2) and (3)), and corresponding provincial legislation of the same nature.

Section 86 addresses the status of other Crown claims, federal and provincial. The general rule is that all Crown claims rank as unsecured claims (section 86(1)), but again there are exceptions. The one most relevant for our purposes is the one introduced in section 86(2)(b): claims that are secured by a security under the governing legislation if the security is registered in accordance with section 87. Section 87 recognizes the validity of such security if there is timely registration pursuant to the regulations.

We see now how dramatically the 1992 amendments have changed the legal and constitutional landscape and how much they have eroded the future significance of the quartet of Supreme Court cases on which Roman and Sweatman rely so heavily. The most important types of deemed trusts, the type that was before the court in *British Columbia v. Henfrey Samson Belair Limited*, are no longer an abomination; Cory J.'s dissenting opinion prevails after all, though one may regret that restrictions are not placed in section 67(2) on the amounts or period of accumulation that may be claimed in respect of the permissible deemed trusts.

For better or worse, sections 86(2)(b) and 87 also repudiate the dogma, the foundation of the other three Supreme Court decisions, that section 136(1) is cast in stone and that Crown claims can never be elevated to the status of secured claims. Finally and not insignificantly, section 87 further knocks the prop from under the Roman-Sweatman contention that perfection requirements and secured creditor status are somehow incompatible under the Bankruptcy and Insolvency Act.

**Two Other Arguments**

In addition to their predominant reliance on the quartet of Supreme Court cases, Roman and Sweatman find ancillary support for their thesis in two other fields of constitutional jurisprudence. The first is the recent
decision of the Supreme Court in *Bank of Montreal v. Hall*;\(^ {45}\) the second involves the doctrine of interjurisdictional immunity as illustrated by the Supreme Court's decision in *Bell Canada v. Quebec (Commission de la santé et de la sécurité du travail)*.\(^ {46}\)

In my view, neither of these precedents supports the authors' case. If anything, *Bank of Montreal v. Hall* directly militates against it. The ratio of *Hall* was that there was a conflict between the Saskatchewan Limitation of Civil Rights Act\(^ {47}\) and the bank's rights under section 178 (now section 427) of the Bank Act, and that the federal legislation must therefore prevail. This conclusion was quite unremarkable and in accordance with earlier precedents in the banking area, but how does it help Roman and Sweatman? What light does it throw on the alleged conflict between section 20(1) of the Ontario Personal Property Security Act and the Bankruptcy and Insolvency Act? Well established banking practice in fact runs counter to the authors' fundamental proposition. Section 427 of the Bank Act only regulates one aspect of the banks' lending and securities' activity. Since the earliest days of Confederation banks have taken other security governed by common law principles and provincial legislation. To the best of my knowledge, it has never been seriously contended, much less decided, that this gave the banks immunity from provincial law where there was no conflict with federal law.

The authors are on no stronger ground in relying on the interjurisdictional immunity doctrine. I will content myself with three short observations. First, the doctrine applies primarily to the regulation of federal services and activities and to federally regulated works and undertakings falling under section 92(10)(a) of the Constitution Act.\(^ {48}\) I am not aware that it has even been applied to the federal government's bankruptcy and insolvency jurisdiction. Second, the doctrine has been criticized by constitutional scholars as anomalous and as an unnecessary deviation from the "pith and substance" and "double aspect" rules of constitutional adjudication.\(^ {49}\)

In the third place, the doctrine is limited to provincial legislation that affects "an integral part" of the federal government's primary and exclusive jurisdiction; it is now also settled that the federal instrumentalities remain subject to provincial statutes of general application provided they do not

---


\(^ {47}\) R.S.S. 1978, c. L-16.


bear upon those subjects "in what makes them specifically of federal jurisdiction". As I have attempted to show earlier, federal bankruptcy legislation has never treated provincial perfection requirements as antithetical to its purposes; on the contrary, the Bankruptcy and Insolvency Act has actively supported the requirements by adding to them in the case of assignment of book debts and, more recently, by making compliance with them a condition of the recognition of Crown liens.

Wrong Target and Wrong Solution

Most odd of all are the authors' reasons for launching their attack on the constitutionality of section 20(1)(b) of the Ontario Personal Property Security Act. The ostensible reason is their concern to maintain the integrity of the Bankruptcy Act's distributional scheme and to prevent a proliferation of divergent provincial rules. However, one does not need to look hard to see that the real motivation is much more modest.

The authors are concerned about the stringency of the Ontario registration rules and the punitive consequences of even trivial errors in the spelling of a debtor's name or the omission of a middle initial in the case of individual debtors. To some extent I share those concerns. I have frequently discussed the problems in published writings, most recently in this Review. Surely then the solution is to seek relaxation of the registration requirements or to improve the Personal Property Security Registry's searching and retrieval procedures. Tenuous constitutional arguments should not be used as stalking horses for much more limited provincial goals.

The authors tell us that as a result of the quartet of Supreme Court decisions the contest between the Bankruptcy and Insolvency Act and section 20(1)(b) of the Ontario Act and corresponding provisions elsewhere is over. They are mistaken. There was no war to begin with. The provincial provisions are valid. The authors should refocus their target and, in the meantime, call home the troops for a well deserved rest!

---


51 In Re Haasen, supra, footnote 6, the case in which Mr. Roman appeared as counsel, the financing statement gave the debtor's common name, the one he had used for many years, but which differed from the rich collection of names appearing on his birth certificate. Farley J. held that the defect was non-curable under s. 46(4) of the Ontario Act since it could have misled a reasonable person.