

## PRIORITY BETWEEN COMPETING SECURED CREDITORS:

### EXPLORING THE BORDERLAND BETWEEN PERSONAL PROPERTY SECURITY RULES AND THE COMMON LAW

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*In the context of priority conflicts between two secured parties, the authors examine the relationship between the priority rules of personal property security legislation and the common law rule (nemo dat quod non habet) in light of the interests of secured parties and the policies inherent in the legislation. Using hypothetical fact situations involving security interests given by different debtors, the article attempts to trace the legitimate limits of the first-to-file, and the purchase money security interest, priority rules. The wording of the legislation of various jurisdictions is examined in order to assess the uniformity of concept and treatment across the spectrum of jurisdictions. It is suggested that the various generations of personal property security statutes, from the UCC through the older Canadian statutes to the more recent New Brunswick Personal Property Security Act, exhibit a development to greater sophistication of articulation and enhanced user-friendliness. The development is most accurately perceived as making explicit rules and policies which, to a greater or lesser degree, remain implicit in the earlier statutes. The authors suggest that, properly understood, the boundary between the statutory priority rules and the common law is drawn consistently across the statutes of the various jurisdictions.*

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*Dans le contexte des conflits de priorité entre deux parties ayant des garanties réelles, les auteurs examinent la relation entre les règles législatives de priorité sur les sûretés mobilières, et les règles de la common law (nemo dat quod non habet) en tenant compte des intérêts des créanciers garantis et des politiques se rattachant à la législation. Employant des situations de faits hypothétiques impliquant des «security interests» données par différents débiteurs, l'article cherche à suivre les limites légitimes des règles sur la priorité d'enregistrement et les règles de priorité pour les sûretés en garantie du prix d'achat. Le texte de la loi des diverses juridictions est examiné afin d'évaluer l'uniformité du concept et du traitement à travers les juridictions. Il est suggéré que plusieurs générations de loi sur les sûretés mobilières, à partir de UCC, passant par les anciennes lois canadiennes jusqu'aux plus récentes lois sur les sûretés mobilières du Nouveau-Brunswick, présentant une plus grande sophistication d'articulation et une amélioration de la facilité d'utilisation. Le développement est perçu plus précisément sous la forme de règles et de politiques explicites qui restaient plus ou moins implicites dans les lois précédentes. Les auteurs suggèrent que, bien comprises, les frontières*

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*entre les règles de priorité établies par la loi et celles établies par la common law sont tracées avec cohérence dans les lois des diverses juridictions.*

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### Introduction

Crossley-Vaines succinctly sets out the primary common law rule regarding transfer of title: "The basic rule as to transfer of title to personal property is that no one can give a better title than his own; he can give possession, but not a title which is not vested in him. *Nemo dat quod non habet*."<sup>1</sup>

American jurisprudence no longer uses the Latin tag but refers to a baseline derivation rule: "In the absence of a specific rule giving a greater or lesser right, a transferee of property acquires those rights that its transferor had and chose to convey, no more and no less."<sup>2</sup>

The function of the *nemo dat* rule is to provide a basis of jurisprudential analysis which begins with an assurance of security of property. Generally speaking, exceptions to the *nemo dat* rule carve out holes in the foundational principle based upon fault considerations of estoppel, entrustment and the desirability of protecting good faith purchasers of the collateral in the interest of the market place's need for some security of transaction.<sup>3</sup> The purpose of

<sup>1</sup> E.G.L. Tyler and N.E. Palmer, *Crossley Vaines' Personal Property*, 5th ed. (London: Butterworths, 1973) 159.

<sup>2</sup> D.G. Baird and T.H. Jackson, *Security Interests in Personal Property, Cases, Problems and Materials*, 2nd ed. (Minnesota, N.Y.: Foundation Press, 1987) at 4. The general rule in the UCC is found at 2-403(1). See also: S. Harris, "Using Fundamental Principles of Commercial Law To Decide UCC Cases" (1993) 26 Loy. L.A. L. Rev. 637 at 638-639.

<sup>3</sup> See generally: J. F. Dolan, "The U.C.C. Framework: Conveyancing Principles and Property Interests" (1979) 59 Boston L. R. 811; G. Gilmore, "The Commercial Doctrine of Good Faith Purchase" (1954) 63 Yale L.J. 1057; I. Davies, "Transferability and Sale of Goods" (1987) 7 Legal Studies 1. UCC 2-403 generally codifies the results of the "rogue" cases that emerged from the common law. An examination of this statute, or the common law cases, shows that the most obvious justification for either is to be found in some formulation of the fault principal. UCC 2A-305 takes a similar position in the case of leases.

personal property security legislation is to take a number of diverse security devices, analyze them pursuant to functional and commercial principles, and bring them within a comprehensive statutory scheme which accommodates the reasonable expectations and conveniences of various interests. The various interests include secured creditors, unsecured creditors both as execution creditors and as represented by trustees in bankruptcy, and purchasers in and out of the ordinary course of business. The interests of secured creditors include: flexibility as to terms and collateral, minimum transactional costs of gaining secured status, trustworthy means of gaining knowledge of other interests in the collateral and certainty of priority based upon investigations which are not fact intensive and difficult of proof.

The personal property security legislation of common law Canadian provinces and the UCC are replete with exceptions to the *nemo dat* rule in favor of persons other than secured parties, for instance, transferees of the collateral and unsecured creditors who find themselves in conflict with a secured party. These exceptions can be explained on the basis of the traditional justifications. For instance, the secured creditor can be perceived to have a secret interest in the collateral thus inducing a third party to extend credit to the debtor on the faith of the ostensible ownership of the collateral arising out of the debtor's possession. Or, a secured party may be cast in the role of an owner who has entrusted the collateral to another. This entrustment renders the secured party vulnerable to the usual spectrum of persons including good faith purchasers. A secured party's ownership and priority in the collateral, when in conflict with someone other than another secured party, is analyzed and decided by assuming that the debtor could give no higher interest in the collateral than she had — *nemo dat quod non habet*. Unless, of course, a statute provides an exception to the *nemo dat* rule.<sup>4</sup>

However, another secured party may also be perceived as a third party who extends credit (albeit secured credit) on the basis of the ostensible ownership arising from possession of the collateral by the debtor. For some types of collateral a subsequent secured creditor can be regarded primarily as a transferee of an interest in the collateral and is included and protected as a member of a class of *bona fide* purchasers for value (usually)<sup>5</sup> without notice. Including a subsequent secured creditor in this protected class serves to lend some degree of negotiability to the specific type of collateral, for example, chattel paper,

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<sup>4</sup> Section 9(1) of the Ontario *Personal Property Security Act*, S.O. 1989, c. 16 (hereinafter OPPSA) provides: "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." To like effect are: UCC 9-201; BCPPSA, s. 9; APPSA, s. 9; SPPSA, s. 9; MPPSA, s. 9; YPPSA, s.63(2); NBPPSA, s. 9.

<sup>5</sup> An example of knowledge being irrelevant is UCC 9-308 (b) which provides that a purchaser may gain priority in chattel paper which is the proceeds of inventory whatever the extent of the purchaser's knowledge. See also OPPSA, s. 28(3); BCPPSA, s. 32 (6)(b); APPSA, s. 31; SPPSA, s.31(5)(b); MPPSA, s. 31; YPPSA, s. 32; NBPPSA, s. 36(1)(b).

instruments and documents of title.<sup>6</sup> But, apart from these special types of collateral,<sup>7</sup> for the purposes of establishing an exception to the *nemo dat* rule, a subsequent secured party under personal property security legislation is not treated in the same way as other credit grantors or transferees. The most notable difference is that a secured party's priority does not usually depend upon whether she had knowledge of the prior security interest. Rather, when two secured parties are in conflict over the same collateral, the statutes establish a number of mechanical rules for establishing priority. These rules are reasonably simple of application and serve to support the goals of certainty, predictability and the absence of costs attendant upon difficult and uncertain factual investigations.

This paper argues the position that, in a priority conflict between two secured parties over the same collateral, the apparently clear and simple rules established in the legislation should be read subject to the common law unless the purposes of personal property security legislation relevant to secured parties clearly support an application of the statutory rules. We attempt to demonstrate that, in certain types of fact situations, the purposes of the legislative scheme are not threatened by an application of the common law principle to the effect that a secured creditor's rights cannot rise above the rights of her debtor.

The exploration proceeds by an examination of two secured parties in a hypothetical fact situation involving a buyer of equipment. The hypothetical is then manipulated in an attempt to assess the legitimate claims and boundaries of the personal property security priority rules. Statutory references are to the mother of personal property security statutes, Article 9 of the Uniform Commercial Code<sup>8</sup> (herein UCC), and the Canadian offspring of a number of common law jurisdictions.<sup>9</sup> We examine the development and increasing

<sup>6</sup> The definition of "purchaser" in UCC 1-201 (32) (33) and s. 2 of OPPSA includes a secured party. Examples of the inclusion of subsequent secured parties in this class are: chattel paper, instruments, negotiable documents of title: see UCC 9-308, 9-309; OPPSA, s. 28(3) (4). In addition, a secured party might be a holder in due course or a transferee of money under UCC 9-309 and OPPSA, s. 29.

<sup>7</sup> In order to avoid considerations surrounding these special types of collateral we use "equipment" as the collateral in our following hypotheticals.

<sup>8</sup> We will not discuss various non-standard amendments that have been enacted by various states. With regard to Articles 2, 2A, and 9 all references will be to the Official Text (1990) as adopted by The American Law Institute and the National Conference of Commissioners on Uniform State Laws.

<sup>9</sup> *Personal Property Security Act*, S.B.C. 1989, c. 36 as am. by 1990, c.11; c.25, ss.53 to 56; 1990, c.53, s.12 (Schedule 1, Items 18, 19); 1991, c.13, ss. 21 to 26; 1992, c.48; 1993, c.28, ss.16, 19 (hereinafter BCPPSA); *Personal Property Security Act*, S.A. 1988, c. P-4.05 as am. by 1990, c.31; 1991, c.21, s.29; 1992, c. 21, s.34 (hereinafter APPSA); *Personal Property Security Act*, R.S.M. 1987, c. P-35 rep. sub. by *Personal Property Security Act*, S.M. 1993, c.14 assented to July 27, 1993, net yet proclaimed (hereinafter (MPPSA (1993))); *Personal Property Security Act*, S.S.1979-80, c. P-6.1 as am. by 1980-81, c.72; 1983, c.11, s.61; 1988-89, c.52, s.13; 1992, c.72 (hereinafter SPPSA); *Personal Property Security Act*, R.S.Y. 1986, c. 130 as am. by 1988, c.17, s.9; 1991, c.11, s.202 (hereinafter YPPSA); *Personal Property Security Act*, S.O. 1989, c. 16 as am. by 1991, c.44, s.7; 1993, c.13, s.2 (hereafter OPPSA); *Personal Property Security Act*, S.N.B. 1993, c. P-7.1 (hereafter NBPPSA).

sophistication of personal property security legislation in the various jurisdictions and conclude that, properly understood, the development and apparent differences do not confound, but rather support, our thesis.<sup>10</sup>

I. *A working example involving two secured creditors  
and the first-to-file rule*<sup>11</sup>

Brava, a manufacturer of widgets, owned a piece of equipment. Pursuant to a written security agreement, Brava granted a security interest to Alpha Bank in January 1992 and Alpha Bank perfected by filing a proper financing statement on January 10, 1992. On February 1, 1992, without the knowledge or consent of Alpha Bank, Brava sold the equipment to Charley Inc.

Stop the example there and ask if Charley's interest in the equipment is subject to Alpha Bank's security interest. It is clear that the answer is in the affirmative. UCC 9-311<sup>12</sup> allows Brava to transfer its interest in the equipment, notwithstanding a contractual prohibition. The Canadian statutes emphasize that no such transfer prejudices the rights of the secured party under the security agreement or otherwise.<sup>13</sup> UCC 9-306(2)<sup>14</sup> reinforces the conclusion that Alpha's security interest continues in a perfected state unless the transfer was authorized by the secured party. This result is, of course, consistent with the *nemo dat* rule. No exception to the *nemo dat* rule can be justified because Charley was at fault. It could and should prudently have searched the public

<sup>10</sup> In this we respectfully and reluctantly differ from some of Professor Cuming's conclusions: see R.C.C. Cuming "Double-Debtor A-B-C-D Problems in Personal Property Security Legislation" (1992) 7 B.F.L.R. 359.

<sup>11</sup> The first-to-file rule is included in all the relevant personal property security legislation: UCC 9-312(5)(a) provides: "Conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected whichever is earlier..."; OPPSA, s. 30, rule 1; BCPPSA, s.35(1); APPSA, s. 35; SPPSA, s. 35; MPPSA, s.35; MPPSA, (1993) s. 35; YPPSA, s. 34; NBPPSA, s. 35.

<sup>12</sup> "The debtor's rights in collateral may be voluntarily or involuntarily transferred (by way of sale, creation of a security interest attachment, levy, garnishment or other judicial process) notwithstanding a provision in the security agreement prohibiting any transfer or making the transfer constitute a default."

<sup>13</sup> BCPPSA, s. 33(2); APPSA, s. 33; SPPSA, s.33; MPPSA, s.33; MPPSA, (1993) s.33(2); OPPSA, s. 39; YPPSA, s. 32; NBPPSA, s. 33(2).

<sup>14</sup> "Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor." The principal exceptions found in Article 9 are included in 9-307. Since the hypothetical involves a sale out of the ordinary course of the seller's business, and does not involve consumer goods or future advances, the exceptions are not relevant here. To like effect is UCC 2A-307(3) and, among Canadian statutes, BCPPSA, s. 28(1); APPSA, s. 28; SPPSA, s. 28; MPPSA, s. 27; MPPSA, (1993) s.28(1); OPPSA, s. 25(1)(a); YPPSA, s. 26; NBPPSA, s. 28. Unlike the UCC, the Canadian jurisdictions make the continued perfection of the security interest dependent upon filing a timely financing change statement: BCPPSA, s. 51(1); APPSA, s. 51; SPPSA, s. 49; MPPSA, s. 50; MPPSA, (1993) s.51(4); OPPSA, s. 48; YPPSA, s. 45; NBPPSA, s. 51.

registry and discovered a notice document — the financing statement. Charley could then discover the particulars of Alpha Bank's security interest.<sup>15</sup>

Now add the following facts:

Charley Inc. signed a written security agreement with Delta Bank on March 1, 1990 granting Delta Bank a security interest in all Charley's equipment both present and after acquired. Delta Bank perfected the security interest by filing a financing statement on March 10, 1990.

As between Alpha Bank and Delta Bank who has priority in the equipment? One solution is that the first-to-file rule<sup>16</sup> dictates that the first to file wins. Therefore, Delta Bank wins.

Another solution would be to use *nemo dat* principles which assumes that Charley Inc. could give a security interest to Delta Bank only in whatever interests in the collateral which Charley had, in other words, Delta Bank's interest could rise no higher than Charley's interest. Therefore, Alpha Bank wins.

Based on a hypothetical<sup>17</sup> raising the same issue, Baird and Jackson wrote: (We change the names of the characters to correspond with our hypothetical.)

9-306(2) and 9-402(7) seem to reinforce the general presumption that ... (Delta Bank) can take a security interest only in what ... (Charley Inc.) has, notwithstanding the timing of its filing. Note, however, that the Code does not provide any explicit answers to a priority dispute between ... (Delta Bank) and ... (Alpha Bank). 9-402(7) tells us that ... (Alpha Bank's) interest remains perfected but it does not tell us explicitly that ... (Alpha Bank's) security interest takes priority over any secured creditor of the transferee.<sup>18</sup>

<sup>15</sup> UCC 9-208 provides a means by which the debtor, but not existing or potential creditors, may obtain information from the secured party about the state of indebtedness and the collateral. In contrast, Canadian statutes provide such means to other interested persons in addition to the debtor: BCPPSA, s. 18; APPSA, s. 18; SPPSA, s. 18; MPPSA, s. 20; MPPSA, (1993) s.18; OPPSA, s. 18; YPPSA, s. 17; NBPPSA, s. 18.

<sup>16</sup> *Supra* footnote 11. After acquired clauses are recognized and, as concerns the first-to-file rule, give equal priority status to after acquired collateral as to original collateral: UCC 9-204; BCPPSA, s. 13(1); APPSA, s. 13; SPPSA, s. 13; MPPSA, s. 13; MPPSA, (1993) s.13; OPPSA, s. 12; NBPPSA, s. 13; YPPSA, s.12.

<sup>17</sup> "Bank lends \$10,000 to Firm and takes a security interest in all of Firm's equipment then existing or thereafter acquired. Firm signs a security agreement and Bank files a proper financing statement in 1984. In 1986, Firm acquires a used machine from Manufacturer. Manufacturer is not in the business of selling machines of the kind. Unbeknownst to Firm, Manufacturer had granted a security interest in the machine to Finance Company in 1985 in return for a \$10,000 loan. Manufacturer signed a security agreement and Finance Company filed a proper financing statement in 1985. Manufacturer's sale of the machine to Firm was in express violation of the security agreement manufacturer entered into with Finance Company. Both Firm and Manufacturer default": Baird and Jackson, *supra* footnote 2 at 380.

<sup>18</sup> *Ibid.* at 381. Baird & Jackson at 6 indicate that Alpha Bank would win based on a derivative rule of priority. See also: J. Ziegel and D. Denomme, *The Ontario Personal Property Security Act: Commentary and Analysis* (Aurora, Ont.: Canada Law Book, 1994) at 232. UCC. 9-306(2) corresponds to s. 25(1)(a) of OPPSA. The relevant part of UCC. 9-402(7) (the third sentence) indicates that a filed financing statement remains effective even

The issue in this hypothetical is whether or not the first-to-file priority rule should be read as being subject to *nemo dat* principles. The issue can be recast in terms of section 72 of OPPSA:

*Except in so far as they are inconsistent with the express provisions of this Act, the principles of law and equity, including the law merchant, the law relating to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake and other validating or invalidating rules of law, shall supplement this act and shall continue to apply. (emphasis added)*<sup>19</sup>

The issue is to decide whether or not the first-to-file priority rule is one of the "express provisions" which are inconsistent with the *nemo dat* rule. Certainly the answer must be that the first-to-file rule is definitely (but justifiably) inconsistent with the *nemo dat* rule where the two security interests are given by the same debtor. The first secured party to file wins even though there may have been a prior security interest, albeit unperfected, given pursuant to a security agreement which is fully binding on the debtor. This is the invariable and justified result of all modern personal property security legislation. The first-in-time secured creditor (SP1) should have complied with the statute and afforded the means of notice to a subsequent secured party by filing a financing statement. By not doing so, SP1 has entrusted the collateral to the debtor and not taken the requisite notice precautions to alert a person taking a subsequent interest in the collateral. The second-in-time secured creditor (SP2) has earned its priority by giving the requisite value to attach the security interest and perfecting by complying with the notice policy underlying the registry system. Hypothetically, SP2 would search the registry before advancing to the debtor and, finding no registration, would reasonably anticipate priority by filing first. However, this exception to the *nemo dat* rule is not triggered by any necessary good faith or detrimental reliance by SP2. Indeed, SP2 will gain priority even though it was not in good faith in the sense that it had actual notice of SP1's unperfected security interest.<sup>20</sup> Thus the priority awarded to SP2 is not

though the secured party knows of and consents to the transfer. This indicates that a secured party under Article 9 does not have corresponding obligations to file a financing change statement as are contained, for example, in s. 48 of OPPSA and other Canadian jurisdictions: see *supra* footnote 13.

<sup>19</sup> This is almost identical to UCC 1-103. See also BCPPSA, s. 68(1); APPSA, s. 66; MPPSA, (1993) s.65(2); SPSSA, s. 64(1); YPPSA, s. ; NBPPSA, s. 65(1); Cuming and Wood give the following doctrines as examples of common law and equity which survive: principle of sheltering, action for conversion against transferee, doctrine of marshalling, and estoppel: R.C.C. Cuming and R.J. Wood, *British Columbia Personal Property Security Handbook* (Toronto: Carswell, 1990) at 339-41.

<sup>20</sup> Baird and Jackson justify this result on efficiency grounds in "Information, Uncertainty, and The Transfer of Property" (1984) 13 J. Legal Studies 299. Phillips justifies it on the basis of mental states of the players involving an analysis of comparative culpability: D. Phillips, "The Commercial Culpability Scale" (1982) 92 Yale L.J. 228. Carlson takes great exception to both Baird and Jackson's and Phillips' analyses and cannot justify favouring the knowledgeable SP2 who gains priority by filing first: D.G. Carlson, "Rationality, Accident, and Priority Under Article 9 of the Uniform Commercial Code" (1986) 71 Minn. L. Rev. 207. Insofar as Carlson's position is based on 9-401(2) of the UCC, one must note that Canadian personal property security legislation includes no such

inspired by good faith purchaser considerations but by a perception that secured creditors are sophisticated players with access to professional advice. The certainty of process and predictability of result are desired results from the point of view of a secured party. The result is best accomplished by a race statute where the victory is to the swift and the winner is easily ascertained.

However, the matter is not so clear (or justifiable) when the security interests have been given by different debtors—Brava Inc. and Charley Inc. in our hypothetical. To give Delta Bank priority is intuitively suspect. Alpha Bank did comply with the personal property security legislation by filing a notice document in a timely and proper fashion. And, except by extraordinary prescience, Alpha Bank could not reasonably be expected to find the financing statement filed by Delta Bank. No matter how sophisticated Alpha Bank might be, it is not apparent how it could protect itself other than by constantly monitoring the collateral. To require this would make the cost of secured credit prohibitive. How then could it be justified to deprive Alpha Bank of its common law right of priority arising from the *nemo dat* doctrine? An exception to the *nemo dat* rule in this fact situation cannot be justified on the basis of protecting the security of the commercial transaction between Delta Bank and Charley because there is no reason to protect that transaction in preference to the transaction between Alpha Bank and Brava. If an exception to the *nemo dat* rule is to be justified it must be on the basis that secured creditors are somehow different from other types of persons who may acquire rights in the collateral. It must be justified on grounds that an application of the first-to-file rule in this fact situation supports the peculiar interests of secured parties. This article argues that no such exception to the *nemo dat* rule can be justified.

## II. The nature and interests of secured creditors

As has been noted, a secured creditor who files first can gain priority over a secured creditor who, although prior in time, did not file a notice document. The result follows even though the subsequent secured creditor had actual notice of prior security interest. The result is justified as responding to the legitimate needs of secured creditors. The need is for certainty in the sense that the rules for gaining priority are formalized and based on events which are public and susceptible to discovery and proof with minimum cost and without intensive investigations of facts which are not public and ascertainable. In addition, awarding priority to the first to file promotes early filing practices and the consequent availability of timely information about what might otherwise be a secret property interest. There is an implicit assumption here that secured parties are players in the game for whom certainty with low transactional costs is valued

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provision. The reason is that all Canadian filing systems are centralized, while virtually all American jurisdictions have both local (county) and central (secretary of state) filing systems. Where one files in the American system depends on the nature and use of the collateral and the status of the debtor. 9-401(2) was designed to deal with situations where the secured party had filed in the wrong registry.



higher than the encouragement of commercial morality. Baird and Jackson characterize the matter as follows:

Any inquiry into knowledge is likely to be expensive and time consuming. It is simply much easier to live in a world in which everyone knows that he must comply with a few simple formalities or lose than to live in a world in which the validity of someone's property rights turns on whether certain individuals had knowledge at some particular time in the past. Those who are required to make appropriate filings, in the main, either are professionals or engage the services of professionals. We think it likely that everyone is ultimately better off with a clear rule than with a legal regime that is somewhat more finely tuned but much more expensive to operate. Ferreting out those who take with knowledge despite a defective filing generally is not worth the uncertainty and the litigation it generates.<sup>21</sup>

Would abandonment of the first-to-file rule in our hypothetical (as we suggest should be done) deny to secured creditors the certainty and avoidance of investigatory costs concerning knowledge of the prior interest? The investigatory costs arose under 19th century statutes<sup>22</sup> and judicial attitudes<sup>23</sup> where a subsequent secured creditor with notice of the prior security interest took subject to the prior security interest even though the prior secured party had not complied with a filing statute. Such a subsequent secured creditor could not be in good faith because of the notice or knowledge. Thus, in any case where SP2 claimed priority, SP1 could allege actual notice or knowledge of SP1's security interest by SP2. There is a *prima facie* credibility to such an allegation where a debtor-creditor relationship exists between SP2 and the same debtor that gave the security interest to SP1. (That is to say, fact situations where the security interests are given by the same debtor.) It was to relieve the parties from allegations of, and investigations into, notice or knowledge by SP2 that the first-to-file rule was included in the personal property security statutes — notice or knowledge by SP2 becomes irrelevant. But, in our hypothetical where there are two debtors, there is little *prima facie* credibility for, or significant danger of abuse by, allegations that SP2 had notice or knowledge of the security interest given by SP1's debtor. In other words, it is not likely that Alpha Bank could or would credibly assert that Delta Bank had actual notice or knowledge of Alpha Bank's security interest given by Brava. Thus, the first to file rule's benefit of avoiding frivolous and costly allegations and investigations of notice does not apply with much force to situations where the security interests are given by different debtors. In addition, awarding priority to the first to file, Delta Bank, does not promote more timely registrations. Both secured creditors in this

<sup>21</sup> Baird and Jackson, *ibid.* at 314. Carlson supports his opposition to this position by positing an amateur secured party who is not sophisticated or professionally aided: Carlson, *ibid.*

<sup>22</sup> See Baird and Jackson, *supra* footnote 2 at 35-58. For example: *Bills of Sale and Chattel Mortgages Act*, R.S.O. 1950, c. 34, s. 7 makes an unregistered mortgage null and void as against, *inter alia*, subsequent mortgagees in good faith for valuable consideration; *The Conditional Sales Act*, R.S.O. 1950, c. 61, s. 2 invalidates an unregistered conditional sales contract against, *inter alia*, a subsequent mortgagee without notice, in good faith and for valuable consideration. Both statutes were repealed by the proclamation of the *Personal Property Security Act*, S.O. 1967, s. 73.

<sup>23</sup> Baird and Jackson, *supra* footnote 20 at 313, footnote 40.

scenario can be assumed to have filed at the earliest possible time. Neither one can be said to have earned priority by having won the race to the registry.

One could argue that the necessity of an investigation of Charley's title will be avoided by giving priority to the first to file, Delta Bank in our hypothetical? Let us add a touch of reliance and even assume that Delta Bank advanced funds to Charley based upon the assessed value of collateral in Charley's possession. Thus, it might be argued that Delta Bank has prejudicially relied upon Charley's possession. Would giving Delta Bank priority, as first to file, avoid the cost of investigating the title of equipment acquired by its debtor, Charley Inc., when assessing the value of the collateral securing the outstanding debt?<sup>24</sup> The answer to this must be in the negative because Delta Bank could still not be sure of priority because, without investigation, it could not know if it or some other secured creditor, Alpha Bank in our hypothetical, had filed first. In order to know who filed first, Delta Bank must investigate and discover the identity of the other secured party. To do that Delta Bank must discover Charley Inc.'s predecessor in title, Brava Inc., and do a search against Brava Inc. in order to discover the existence of Alpha Bank and the date of its filing. If one relied on the *nemo dat* rule, instead of the first-to-file rule, Delta Bank would be required to make the same investigations. No certainty is added to Delta's position by allowing the first-to-file rule to override *nemo dat* principles in this type of fact situation.

### III. Purchase money security interest (PMSI) priority

9-312(3) and (4) of the UCC provides that a secured creditor having a "purchase money security interest", and who jumps through the appropriate 'hoops'<sup>25</sup> "...has priority over a conflicting security interest in the same collateral..." Here we create a new hypothetical<sup>26</sup> in order to explore the interface between the *nemo dat* rule and the wording of the pmsi priority sections:

Fox owned a piece of equipment. Pursuant to a written security agreement, Fox granted a security interest to Elco Bank in January 1992 and Elco Bank perfected by filing a proper financing statement on January 10, 1992. On February 1, 1992, without

<sup>24</sup> One must quickly note that relieving Delta Bank of the necessity of such an investigation goes beyond any exception to the *nemo dat* rule provided to any other transferees of goods (except sometimes for serial numbered goods, see Cuming, *supra* footnote 10 at 368ff.) and approaches giving Delta Bank something in the nature of the rights awarded, in the interests of negotiability, to transferees of instruments, chattel paper, document of title and securities: see *supra* footnote 5 and accompanying text. Our point here is that, in any event, such a rule would not save Delta Bank the necessity of investigating Charley's title.

<sup>25</sup> We take the imagery from J.J. White and R.S. Summers, *Uniform Commercial Code*, 3rd ed. (Philadelphia: The Institute, 1988) at 1146. The "hoops" depend on whether the collateral is equipment or inventory. In the latter case, the hoops are more formidable than in the former. See also: BCPPSA, s. 32(1); APPSA, s. 34; SPPSA, s. 34; MPPSA, s. 34; MPPSA, (1993) s.34; OPPSA, s. 33; YPPSA, s. 33; NBPPSA, s. 34.

<sup>26</sup> We create a new hypothetical here because of Delta Bank's difficulty in attaining pmsi status under an after acquired property clause. The definition of "purchase money security interest" in all the statutes (UCC 9-107; BCPPSA, s. 1; APPSA, s. 1; SPPSA, s. 2; MPPSA, s. 1; MPPSA, (1993) s.1; OPPSA, s. 1; YPPSA, s. 1; NBPPSA, s. 1) requires

the knowledge or consent of Elco Bank, Fox sold the equipment to Golf. In order to pay the purchase price to Fox, Golf borrowed the money from Haval Bank. Haval Bank took a security interest from Golf and filed a proper financing statement on February 1, 1992.

Does Haval Bank now gain priority over Elco Bank by virtue of the apparently clear words of 9-312(4)? Or, is this another section where, as has been suggested respecting the basic priority rules under 9-312(5), the words of the statute must be read subject to the *nemo dat* principles? We suggest that the apparently clear words of 9-312(4) should not be applied in this fact situation to give Haval Bank priority. Our reasoning is similar to the treatment of the first-to-file priority rule: overriding *nemo dat* principles to award priority to Haval Bank does not support any of the objectives of personal property security legislation. The purpose of the pmsi priority sections is to allow subsequent suppliers or lenders who finance acquisitions of new collateral to gain priority over a prior secured party with an after acquired property clause. To allow the first-in-time secured creditor with an after acquired property clause to retain its priority based on first-to-file principles would be to allow such first secured creditor an unearned and undeserved windfall. In addition, the possibility of purchase money priority facilitates competition, and avoids a situational monopoly, by allowing the debtor to shop around for the best credit terms while still being able to provide first priority in the financed collateral.<sup>27</sup>

Allowing Haval Bank to gain priority over Elco Bank supports none of these purposes. Haval Bank did not provide the financing which allowed the collateral to come under Elco Bank's secured interest. Elco Bank had that interest before Haval Bank advanced to Golf. And allowing Haval Bank priority would not, in any legitimate sense, facilitate Fox's ability to shop around for the best credit terms. As we argued in the case of the first-to-file priority rule, such an interpretation does not further the interests of secured creditors in certainty of transaction nor does it encourage early filing. Therefore, we suggest that purchase money priority in this four party scenario must be read subject to *nemo dat* principles and Elco Bank should retain its priority.<sup>28</sup>

If we altered our hypothetical so that both banks had purchase money security interests, the special priority rules governing them would not resolve the dispute. We would then be confronted with the same problem we encounter when neither security interest is a pmsi. The arguments discussed with regard to our first hypothetical apply with equal force here.<sup>29</sup>

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a lender to give "value for the purpose of enabling the debtor to acquire rights in the collateral..." (emphasis added). Thus Delta Bank could not claim to have a pmsi where it's money was used to purchase the collateral unless, apparently, the value was made available specifically for the purpose of acquiring rights in the collateral. See R. McLaren, *Personal Property Security: An Introductory Analysis*, 5th ed. (Toronto: Carswell, 1992) at 5-30.

<sup>27</sup> See Official Comment to UCC, 9-312, para 3 and see Ziegel and Denomme, *supra* footnote 18 at 259.

<sup>28</sup> See Ziegel and Denomme, *ibid.* at 261.

<sup>29</sup> Under the terms of some Canadian legislation, the secured party in the position of Elco Bank might be able claim a seller's pmsi. A seller's pmsi has priority over a lender's

#### IV. Predictability and consistency of treatment

It is true to say that the common law invokes the concept of "fault" as a primary device for allocating losses. In commercial law, the fault concept has been expanded in recent years to include an examination of which party had easier access to information that could have been used to prevent or minimize the loss. We believe that we have demonstrated that fault, in any of its formulations, does not uniquely select either *nemo dat* or the first-to-file rule as appropriate in the category of cases identified by our hypotheticals.

However, it is also true to say that we should always be concerned with identifying rules that will allow parties to successfully predict outcomes at the time that they enter into a transaction. All lawyers know that this goal is aspirational but not, in all cases, realizable. In cases where circumstances preclude predictability of outcome for all parties concerned, the next consideration must be to identify a consistent rule that will allow the parties to reasonably predict the resolution of the dispute. Litigation, particularly in the American system, precludes real winners in most commercial disputes. It merely identifies who loses the least. Of course, the uniform adoption of either the first-to-file or the *nemo dat* rule would accomplish this goal of predictability. The question remains as to whether there are reasons for selecting one over the other. We suggest that greater predictability is achieved by selecting the *nemo dat* rule in the fact situations we have described.

In both common and statutory law, exceptions to the *nemo dat* rule have been identified on the basis of the fault principal. If *nemo dat* is the basic rule, we should depart from it only where we have a recognized reason for doing so. Personal property security law is only a part of the larger law of personal property. Consistency of criteria for departure from basic rules should be an important consideration in any discussion concerning the identification of rules for resolving conflicts found within any segment of the larger law of personal property. We believe that this weighs heavily in favor of *nemo dat*.

We suggest that selecting the *nemo dat* rule minimizes the contradictory treatment for similar transactions depending on whether or not they fall within the scope of the personal property security legislation of a particular jurisdiction. Some jurisdictions include some consignments and leases within the scope of the legislation even though the transaction does not in substance create a security interest.<sup>30</sup> Some do not unless the lease or consignment is in substance a security

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pmsi, for example: OPPSA, s. 33(3); BCPPSA, s. 34(4); APPSA, s. 34(5); MPPSA, (1993) s.34(5); NBPPSA, s. 34(4); YPPSA, s.33(7). We would argue, and the wording of the statutes confirms (see *infra*), that such priority to a seller's pmsi does not apply to fact situations where the pmsi's are given by different debtors.

<sup>30</sup> BCPPSA, s. 3 includes commercial consignments and leases for a term of more than one year, both of which terms are further defined and limited in the definitional section (s. 1). To like effect are: APPSA, s. 3; MPPSA, (1993) s.3(2); SPPSA, s. 3; NBPPSA, s. 3; YPPSA, s.2(6). In the UCC, consignments are treated in Article 2 (2-326), which requires consignors to file pursuant to Article 9 (see 9-114; 9-401; 9-402; 9-408) in order to protect against both secured and unsecured creditors of the consignee.

interest<sup>31</sup> — a determination which is fraught with uncertainty.<sup>32</sup> If, contrary to our submissions, the first-to-file rule awarded priority to Delta Bank, then it must be true that the result would be reversed if Alpha Bank were a true lessor or consignor in a jurisdiction which did not include true leases and consignments within the scope of its legislation. Alpha Bank would be benefited by its exclusion from the legislation and the consequent application of the *nemo dat* rule. Alpha Bank will be treated differently in various jurisdictions, depending on the scope of the particular personal property security legislation, in spite of the fact that third parties are equally susceptible to being misled as to property interests whether Alpha Bank is a secured party or a lessor or a consignor. This difference of treatment for similar transactions is an inherent difficulty with any personal property security legislation. It is a problem which every jurisdiction must solve in light of its own commercial environment. However, if, as we suggest, the personal property security priority rules between secured parties are subject to *nemo dat* principles in some cases where the security interests are not created by the same debtor, then at least the different treatment of similar transactions is limited to a narrower class of fact situations. Beyond the boundary which limits the narrower class (conflicts between secured creditors where the competing security interests were created by the same debtor and cases where, although the security interests were not created by the same debtor, a secured party has failed to comply with the filing requirements of the particular legislation) all transactions are treated the same whether or not they fall within the scope of the personal property security legislation of the particular jurisdiction.

We regard as mischievous the suggestion that the personal property security legislation of some jurisdictions retains the common law position for which we argue while others have moved to a comprehensive first-to-file system.<sup>33</sup> We find our inclination reflected in subsection 2(5) of NBPPSA.:

This Act is to be interpreted and applied, insofar as the context permits, in a manner that promotes the inter-jurisdictional harmony of the law of personal property security in Canada.<sup>34</sup>

We suggest that, in fact, starting with Article 9, then to OPPSA and the Western Canadian legislation and finally to the most recent progeny, NBPPSA, one observes a trend and development towards greater degrees of user-friendliness in personal property security legislation. In the context of our

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<sup>31</sup> UCC 9-102; MPPSA, s. 2. Although, in 1984, the Advisory Committee recommended the inclusion of consignments and leases for a term of more than one year in the OPPSA, s. 2 of the *Personal Property Security Act, 1989* only applies to transactions that in substance create a security interest. See Minister of Consumer and Commercial Relations, *Report of the Minister's Advisory Committee on the Personal Property Security Act* (Toronto: Ontario Ministry of Consumer and Commercial Relations, 1984) at 26.

<sup>32</sup> See generally: White and Summers, *supra* footnote 25 at 928; Baird and Jackson, *supra* footnote 2 at 103.

<sup>33</sup> See: Cuming *supra* footnote 10.

<sup>34</sup> Needless to say, the advent of the *North American Free Trade Agreement* makes it very desirable that there be as much harmony and consistency as possible between Canadian jurisdictions and Article 9 jurisdictions.

enquiry, the priority rules governing a dispute between secured parties in the same collateral have been refined in the interests of greater clarity. But, we believe the *nemo dat* rule remains the foundational principle and is not departed from except where the policies of personal property security legislation justify such a departure. The Western Canadian and New Brunswick statutes have included provisions which clarify and put beyond dispute the results of certain types of priority disputes. We suggest that these provisions simply make explicit what is implicit in Article 9 and, perhaps to a lesser degree, in OPPSA. The provisions define the limits of the first-to-file rule and indicate a result which is consistent with the *nemo dat* rule. In this exercise of clarification, the Western Canadian statutes and NBPPSA have achieved a higher and more desirable degree of logical sophistication and articulation but they have not completely displaced the *nemo dat* rule in favour of the first-to-file rule.

We now proceed to attempt to support and demonstrate our interpretation of the legislative differences and development. We begin with the two hypotheticals through which we sought to explore the policies inherent in personal property legislation in fact situations involving disputes between secured creditors over the same collateral. We then examine two fact situations involving proceeds and future advances which, we believe, also demonstrate our thesis.

#### A. *Alpha Bank in Conflict with Delta Bank*

If our argument is well founded the conclusion must be that in our hypothetical fact situation the first-to-file rule does not apply and we must look to common law to settle the priorities of the secured parties. What was the common law position which flowed from the *nemo dat* rule? In the case of chattel mortgages it appears that the mortgagee would prevail against a subsequent purchaser or pledgee from the mortgagor provided he could show his interest and right to immediate possession under the mortgage terms.<sup>35</sup> In the case of conditional sales contracts or contracts of hire purchase, the common law, prior to the first English Bills of Sales Acts,<sup>36</sup> was that the

... seller who stipulated that title should not pass until the goods had been completely paid for was entitled to assert his right of ownership against a third party to whom the buyer disposed of the goods before payment, whether or not the third party had purchased in good faith.<sup>37</sup>

A bill of sale without delivery of possession to the grantee was impeachable only if it was proved to be in fraud of creditors.<sup>38</sup>

<sup>35</sup> Tyler and Palmer, *supra* footnote 1 at 447, note i, citing *Thompson v. Pettitt* (1847), 10 Q.B. 101 decided before the first *Bills of Sale Act* was passed.

<sup>36</sup> *Bills of Sale Act, 1854* (U.K.), 1854, C.36; *Bills of Sales Act, 1878* (U.K.), 1878, c.31; *Bills of Sale Act, 1878 Amendment Act*, (U.K.), 1882, c.43.

<sup>37</sup> R.M. Goode and J.S. Ziegel, *Hire-Purchase and Conditional Sale* (London: British Institute of International and Comparative Law, 1965) at 9-10.

<sup>38</sup> The fact that the grantor remained in possession was only evidence of fraud: Tyler and Palmer, *supra* footnote 1 at 450.

However, any form of secret interest in chattels could be regarded with suspicion by the courts as being in fraud of creditors. Early English<sup>39</sup> and especially American<sup>40</sup> decisions rendered vulnerable security interests which were not apparent to the public by a change of possession. By the beginning of this century, in order to offer public notice, registration statutes were common.<sup>41</sup>

If, as we suggest, the first-to-file rule does not apply to the hypothetical, is the secured party (Alpha Bank) better off under common law rules? We answer in the affirmative and suggest that Alpha Bank will prevail based on pure *nemo dat* principles: Brava held the equipment subject to Alpha Bank's security interest and Brava could give no higher title to Charley and, therefore, Delta Bank can have no higher rights than its debtor, Charley. The early jurisprudence concerning secret security interests arising from the *Statute of Elizabeth* no longer has any relevance because, *ex hypothesi*, both secured parties did file a public notice document against their own debtor. Any secrecy surrounding the security interests is not the product of any action or omission of the secured party but rather of the inherent difficulty in discovering ownership rights in moveable property. American and Canadian jurisdictions have sought to remedy this inherent difficulty by creating appropriate and justifiable exceptions to the *nemo dat* rule.<sup>42</sup> They have declined to move generally away from a derivative rule to embrace a *possession vaut titre* regime whereby any entrustment of goods allows the entrustee to transfer the goods free of the entruster's interest.<sup>43</sup>

Of course, if either Alpha Bank or Delta Bank did not file the requisite notice document, the non-filing secured party must lose a priority dispute in favor of the secured party who has perfected the security interest. In other words, we would apply the rules of the personal property security legislation to a dispute between a perfected and an unperfected security interest even though the security interests were given by different debtors. In this we are not inconsistent. We do so because the policy of the common law and the relevant statutes is to encourage notice and filing and to punish non-filing. Therefore, to deny priority to the non-filing secured party affirms and supports the policies of the common law and statutes. For the same reason we would deprive Alpha Bank of priority for any interests acquired by Delta Bank (or anyone else) who acquired these

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<sup>39</sup> *Twyne's Case* (1601), 3 Co. Rep. 806, 76 E.R. 809 where Coke C.J. gave the following advice: "1. Let it (the transfer) be made in a public manner, and before the neighbours, and not in private, for secrecy is a mark of fraud. 2. Let the goods and chattels be appraised by good people to the very value and take a gift in particular satisfaction of your debt. 3. Immediately after the gift, take possession of them; for continuance of the possession in the donor is a sign of trust". "Trust" here means cover of fraud: Tyler and Palmer, *supra* footnote 1 at 466, note m.

<sup>40</sup> *Clow v. Woods*, 5 S. & R. 275 (Pa. 1819) *Sturtevant v. Ballard*, 9 Johns. 337 (1812).

<sup>41</sup> See J. Ziegel, "Personal Property Security and Bankruptcy: There Is No War!" (1993) 72 C.B.R. 44 at 48-50.

<sup>42</sup> For a good survey of the exceptions in the context of sale of goods, see Ontario Law Reform Commission, *Report on Sale of Goods*, (Toronto: Ministry of the Attorney General, 1979) v. II, c. 12.

<sup>43</sup> *Ibid.* at 306-309.

interests during the period, after Alpha Bank acquires knowledge of the transfer from Brava to Charley and before Alpha amends the registry to reflect the new debtor, when Alpha Bank's security is vulnerable pursuant to the various sections of the Canadian statutes.<sup>44</sup> Alpha Bank loses priority because it failed to meet the timely registration requirements of the statutes.

An unperfected Alpha Bank will lose priority even if Charley is subject to Alpha Bank's security interest because, for instance, Charley had notice of the security interest.<sup>45</sup> Alpha Bank will lose because the priority rule is that the perfected security interest of Delta Bank beats the unperfected Alpha Bank. This result is, of course, an exception to the *nemo dat* rule which runs in favour of Delta Bank (irrespective of Charley's defective title) because of the policy of PPSA legislation to reward notice filing and punish non-filing. In fact, as has been noted,<sup>46</sup> Delta Bank will gain priority over Alpha Bank's unperfected security interest even if Delta Bank had actual notice of Alpha's prior unperfected security interest.

We suggest that the result will be the same under the provisions of many of the Western Canadian statutes<sup>47</sup> and the NBPPSA. They have articulated a position which is implicit in Article 9, OPPSA and MPPSA. We use the NBPPSA for illustration. Section 35(8) reads:

If a debtor transfers an interest in collateral that, at the time of the transfer, is subject to a perfected security interest, that security interest has priority over any other security interest granted by the transferee before the transfer, except to the extent that the security interest granted by the transferee secures advances made or contracted for

(a) after the expiry of 15 days from when the secured party who holds the security interest in the transferred collateral has knowledge of the information required to register a financing change statement in accordance with section 51 disclosing the transferee as the new debtor, and

(b) before the secured party referred to in paragraph (a) takes possession of the collateral or registers a financing change statement in accordance with section 51 disclosing the transferee as the new debtor.

## B. *Elco Bank in Conflict with Haval Bank*

As indicated above, in a dispute between two secured parties over the same collateral, we interpret 9-312 (3) (4) as giving superpriority to pmsi's created only by the same debtor. We accomplish the result by reading the subsections

<sup>44</sup> OPPSA, s. 48(2); BCPPSA, s. 51(2); APPSA, s. 51(2); SPPSA, s. 49(2); MPPSA, s. 50(2); MPPSA, (1993) s.51; NBPPSA, s. 51(2); YPPSA, s.45.

<sup>45</sup> We appear to disagree with Professor Cuming and Professor Barkley Clark insofar as we suggest that this would be the result under all the subject PPSA legislation including UCC: Cuming, *supra* footnote 10 at 365.

<sup>46</sup> *Supra* footnote 20 and accompanying text. This seemingly strange exception to the *nemo dat* rule, that Charley is subject to Alpha Bank's security interest but Delta Bank has priority over Alpha Bank, demonstrates the special nature and interests of secured creditors.

<sup>47</sup> BCPPSA, s. 35(8); APPSA, s. 35(7); MPPSA, (1993) s.35(8); SPPSA, s. 35(6); YPPSA, s.34(6).



of Article 9 as being subject to the *nemo dat* rule except where awarding the benefits of superpriority support the policy objectives of pmsis.

Before 1989, section 33 of the Ontario *Personal Property Security Act*<sup>48</sup> provided for pmsi priority in substantially the same terms as the UCC. By the *Personal Property Security Act, 1989* the inventory and non-inventory pmsi priority sub-sections were changed to read as follows (emphasis added):

... a purchase-money security interest in collateral or its proceeds has priority over any other security interest in the same collateral *given by the same debtor*...<sup>49</sup>

The reason for the amendment was stated in the *Report of the Minister's Advisory Committee*.<sup>50</sup>

The words "given by the same debtor" have been added to the opening part of the subsection to *clarify that the rule is only concerned with disputes involving a common debtor*. The effect of the words is that a financier of used inventory will not obtain priority over a prior secured party holding a security interest granted by a prior possessor (owner) on the inventory. (emphasis added)

Our submission in this paper implies that this Canadian variation is unnecessary and, as stated above, merely serves to clarify a rule. That is not to say that the Canadian clarifications are not beneficial. Personal property security legislation is conceptually strange and technically difficult for most people who do not deal with it on a continual basis. Any clarifications which aid the practitioner and judiciary to reach expeditious and predictable results are greatly to be desired.<sup>51</sup> The 1989 clarifications concerning pmsis in the OPPSA thus support the purposes of all commercial law generally and personal property legislation in particular.<sup>52</sup>

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<sup>48</sup> R.S.O. 1970, c. 344.

<sup>49</sup> OPPSA sub-sections 33(1) (inventory) and 33(2) (non-inventory). The phrase appears in almost all the relevant sections of all the Canadian statutes: *supra* footnote 25. The exception is MPPSA in which subsections 34(2) (4) do not include the words "given by the same debtor" but the words are contained in MPPSA (1993) s.34(2) (3).

<sup>50</sup> *Report of The Minister's Advisory Committee on The Personal Property Security Act*, *supra* footnote 31 at 51, para. 2.

<sup>51</sup> The 1989 amendments to OPPSA would, however, be mischievous if a court attempted to give meaning to all the words of the relevant sections and failed to realize that the basic rule of first-to-file is limited by the *nemo dat* principle as suggested in this article. Such a misapprehension might lead a court to the following interpretation which supports Delta Bank's priority in our first hypothetical: the first-to-file rule operates to give priority to Delta Bank unless the pmsi rule operates to give priority to Alpha Bank. But the Canadian pmsi rules (except MPPSA) cannot operate to give Alpha Bank priority because the competing security interests were not "given by the same debtor". Thus Delta Bank must have priority.

<sup>52</sup> Of course, an amending statute does not involve a declaration that the previous law was different from the law as it is under the amendment: see P.A. Côté, *The Interpretation of Legislation in Canada*, 2nd ed. (Cowansville: Yvon Blais, 1991) at 439-40, and the *Interpretation Act*, R.S.C. 1985, c. I-23, s. 45(2).

### C. Jack and Jill and the proceeds

All the subject personal property security legislation provides that, where collateral gives rise to proceeds, the security interest extends to the proceeds. The security interest which extends to the proceeds can be, according to different requirements of the various statutes, a continuously perfected security interest.<sup>53</sup> This proceeds rule is something like an after acquired property clause in that it produces priority problems arising from the possibility of a sort of backdating of a security interest over new collateral. It's similar to the effect we created in the first two hypotheticals and can involve basic priority rules as well as PMSI superpriority rules. At the risk of tiring our readers, we create another hypothetical:

Jack owned a banjo and gave Bank a non-pmsi security interest in the banjo on Jan. 15. On Jan. 16 Bank filed a proper financing statement.

Jill owned a guitar and gave Finco a non-pmsi security interest in the guitar on Feb. 16. On Feb. 16 Finco filed a proper financing statement.

On March 15 Jack realized that his musical genius was in guitar music and Jill realized her forte in banjo picking. Therefore, without the knowledge of Bank and Finco, Jack and Jill traded their musical instruments.

Both Jack and Jill default. As between Bank and Finco what are the interests and priorities in the guitar and banjo?

An application of UCC, OPPSA and MPPSA might tempt (erroneously) the following reasoning: Bank's security interest in the banjo extends to the guitar and is a perfected security interest. Since no other priority section applies, first-to-file must decide the priority in both the banjo and the guitar.

In this article our line of reasoning has been that the *nemo dat* rule applies unless the policies of the personal property security legislation (supported by the wording of the statutes) indicate otherwise. Here, both secured parties have filed in a timely fashion. Therefore, our solution, is to apply the *nemo dat* rule and allow Bank and Finco priority only in their original collateral.

Since the Bank's security interest attached to the guitar by virtue of Jack having granted a security interest in the banjo, NBPPSA would classify Bank's security interest (vis a vis the guitar) as "...any other security interest granted by the transferee before the transfer. . . " and apply s. 35(8).<sup>54</sup> The result is thus the same as is reached by application of the *nemo dat* rule.

If we change the facts slightly to make either or both the security interests pmsis which have jumped through the requisite timely filing "hoops", we suggest that the result should not change. What justification, consistent with the policies which support pmsi superpriority or timely filing, can be advanced to deprive Finco of common law priority in the guitar under the *nemo dat* rule?<sup>55</sup>

<sup>53</sup> BCPPSA, s. 28; APPSA, s. 28; SPPSA, s. 28; MPPSA, s. 27; MPPSA, (1993) s.28; OPPSA, s. 25; NBPPSA, s. 28; UCC 9-306; YPPSA, s.26.

<sup>54</sup> *Supra* footnote 46.

<sup>55</sup> BCPPSA, s. 34(6); APPSA, s. 34(7); MPPSA, (1993) s.34(7) and SPPSA, s. 34(5) are similar to NBPPSA, s. 34(5) and were included to reverse such a commercially unacceptable

### D. *Future advances*

Article 9 and all the subject Canadian statutes validate future advance clauses contained in a security agreement.<sup>56</sup> For deciding priorities between secured creditors in the same collateral, it may matter whether the future advance was made pursuant to commitment or not<sup>57</sup> and, in order to gain priority of the first-to-file rule, the security interest of the future advancer must be perfected when the advance was made.<sup>58</sup> Whatever the position was at common law, when dealing with other secured creditors in the same collateral, all personal property legislation appear to treat future advance clauses in the same manner as any other clause in the security agreement. Therefore, by the reasoning of this article, future advance clauses will bind a subsequent secured creditor whether or not the subsequent security interest is given by the same debtor. This is an application of the *nemo dat* rule.<sup>59</sup> However, consistent with

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result in a type of fact situation involving competing pmsis. NBPPSA, s. 34(5) reads:

A purchase money security interest in collateral as original collateral has priority over a purchase money security interest in the same collateral as proceeds, if it is perfected

(a) in the case of inventory, when a debtor, or another party at the request of a debtor, obtains possession of the collateral, whichever is earlier, and

(b) in the case of collateral other than inventory, within fifteen days after a debtor, or another person at the request of a debtor, obtains possession of the collateral, whichever is earlier.

The B.C., Alberta, Manitoba and New Brunswick sections do not specifically restrict the operation of the subsections to purchase money security interests *given by the same debtor*. SPPSA s. 34(5) and YPPSA s.33(5) do so by referring to subsections (1) and (2) which set out the rules for inventory and non-inventory purchase money security interests "given by the same debtor". We suggest that all these subsections must be read as being applicable only to fact situations where the purchase money security interests are given by the same debtor. Otherwise, exceptions to the *nemo dat* rule would be created which cannot be justified by the policies supporting the statute. For instance, assume a fact situation where Bank had a pmsi (and had filed within the requisite period) but Finco did not have a pmsi or, having one, did not file within the requisite period. Using these sections to argue that Bank (with its pmsi) has priority over Finco would not support or be justified by the purposes of pmsi superpriority: see *supra* footnote 27 and accompanying text. We further note that Cuming and Wood's examples used to illustrate the application of BCPPSA s. 34(6) and APPSA s. 34(7) involve pmsis given by the same debtor: Cuming and Wood, *British Columbia Personal Property Handbook*, *supra* footnote 19 at 201; R.C.C. Cuming and R.J. Wood, *Alberta Personal Property Security Handbook*, (Toronto: Carswell, 1990) at 200.

<sup>56</sup> UCC 9-204(3); OPPSA, s. 13; BCPPSA, s. 14(1); APPSA, s. 14(1); SPPSA, s. 14(1); NBPPSA, s. 14(1); MPPSA, s. 15; MPPSA, (1993) s.14.

<sup>57</sup> UCC 9-312(7) requires that the advance be "pursuant to commitment" as defined in 9-105 in order to gain priority over a subsequent secured party. OPPSA, s. 30(3); BCPPSA, s. 35(5); APPSA, s. 35(4); MPPSA, (1993) s.35(5); SPPSA, s. 35(4); YPPSA, s.34(4); NBPPSA, s. 35(5) do not require that the advance be pursuant to a commitment.

<sup>58</sup> OPPSA, s. 1 "future advance", s. 30(3), SPPSA, s. 35(4) and YPPSA, s.34(4) make this clear while BCPPSA, s. 35(5), APPSA, s.35(4), MPPSA, (1993) s.35(5) and NBPPSA, s.35(5) are not so clear but such must be the case. See Cuming and Wood, *supra* footnote 19 at 94-95.

<sup>59</sup> We believe it is supported by appropriate sections of all ppsa legislation: see *supra* footnote 4. In this we appear to disagree with Professor Cuming: Cuming, *supra* footnote 10 at 380.

our reasoning, failure to comply with timely filing requirements may lead to a security becoming unperfected or subordinated.<sup>60</sup> In such a case the policy in favour of timely filing will support and justify the exception to the *nemo dat* rule and subordinate the future advance.

### Conclusion

In this article we have attempted to explore and elucidate some part of the borderland where personal property security legislation speaks to issues which at common law were analyzed, in the interests of protecting property rights, by the Latin tag *nemo dat quod non habet*. In particular we have identified four-party fact situations involving two debtors and two competing secured parties and examined the issue of priorities between the secured parties in light of the first-to-file rule and the policies supporting its application in personal property security statutes. Our conclusion is that, in these fact situations where the security interests are given by different debtors, an application of the first-to-file rule does not support the policies which explain and justify the acceptance and inclusion of the first-to-file rule in personal property security statutes. Therefore, in these fact situations, the better analytical tool is the common law rule of *nemo dat* which, except where changed by statute, establishes priority rules which support the security of ownership. We have attempted to analyze the various generations of personal property security legislation from the parent UCC Article 9 to the most recent New Brunswick *Personal Property Security Act*. Our suggestion is that the developments of the various statutes are best regarded as clarifications of the position which is implicit in Article 9: the first-to-file rule should be read subject to *nemo dat* principle unless the purposes and policies of the legislation indicate otherwise. Read in this way, we suggest that Article 9 and all the personal property legislation in common law Canada are conceptually uniform.<sup>61</sup>

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<sup>60</sup> As for instance where the secured party acquires notice that the collateral has been transferred sufficient to file a financing statement and fails to do so: OPPSA, s. 48; BCPPSA, s. 51; APPSA, s. 51; SPPSA, s. 49; MPPSA, s. 50; MPPSA, (1993) s.51; NBPPSA, s. 51; YPPSA, s.45(1).

<sup>61</sup> Unlike Professor Cuming, *supra* footnote 10 at 370-74, we do not perceive the Canadian provisions concerning serial number goods to be of such dramatic import. We view it as a natural and practical method of providing more information in cases where it is practicable to do so. It is perfectly compatible with the common law and early statutory emphasis on notice of security interests. The fact that it is unavailable in the American jurisdictions has nothing to do with theory but rather with the fact that the American systems were established before computers made such a system feasible. It would require an entirely separate index of hard copies of financing statements. One must remember that all states have dual registration systems (state and county). Requiring registration by serial number would create space and cost problems that state and county governments would not be willing to accept. The Canadian systems are more efficient and precise. They do not, however, represent a shift from well established *nemo dat* rules. At least we are not inclined to think so without some clearer statements of legislative intention.