

SECURED CREDITORS' NON-STATUTORY REMEDIES: UNFINISHED BUSINESS

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When personal property collateral taken under a security agreement has been damaged, destroyed or otherwise cannot be seized, the secured party must look to remedies outside the Personal Property Security Act. In almost all cases, this will involve a traditional “property tort” action. In this article, the author examines the actions of trespass, detinue, conversion and damage to a reversionary interest and concludes that none of them provides an appropriate method of addressing damage to or loss of a secured creditor’s in rem interest in the collateral. In the balance of the article, the author proposes a new statutory remedy that interfaces with the Personal Property Security Act and reflects the limited proprietary nature of a security interest.

Lorsque des biens meubles donnés en sûreté ont été endommagés, détruits ou ne peuvent, pour toute autre raison, faire l’objet d’une saisie, le créancier garanti doit se tourner vers des recours en dehors de la Loi sur les Sûretés mobilières. Dans presque tous les cas, cela comprendra une poursuite plus traditionnelle pour « délit civil contre les biens ». Dans cet article, l’auteur examine les poursuites pour atteinte directe, détention illicite, conversion et dommage causé à un intérêt réversif. Il conclut qu’aucune de ces poursuites n’offre de méthode appropriée pour traiter du dommage subi par le créancier garanti dans ces circonstances. Par la suite, il propose un nouveau recours légal ayant un lien avec la Loi sur les Sûretés mobilières et qui reflète la nature limitée du droit de propriété d’une sûreté.

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1. Introduction

The *Personal Property Security Act (PPSA)*¹ is a code of law addressing the creation, priority and enforcement of statutorily recognized *in rem* interests² (security interests) in personal property. It leaves to non-code law other rights a secured party may have associated with those interests. When determining what non-statutory remedies secured parties have, courts in both Canada and the United States³ have looked to traditional tort law associated with protection of interests in personal property – often referred to as “property tort” law. The general approach has been to accept this as an appropriate source on which to draw. Other than through seizure and sale in accordance with Part V of the Act, a judgment for damages in a common law tort action for conversion has been the principal method of recognizing the interests of secured parties in collateral.

The application of traditional property tort law as a basis for recovery by a secured party in cases where the collateral has been transferred by the debtor to a transferee, such as a buyer who has acquired the collateral in a non-ordinary course transaction⁴ and who is not protected by a priority rule of the *PPSA*, could produce the following results.⁵ A secured party cannot bring an action unless he or she had at the date of the transfer either actual possession or an immediate right to possession of the collateral.⁶ When this

¹ In this article, reference will be made to provisions of *The Personal Property Security Act, 1993*, SS 1993, c P-6.2 [*PPSA*] (as amended) which, for the purposes of this article, is representative of secured transactions legislation in all common law jurisdictions.

² In this paper, the term “*in rem*” is used to label a property right in personal property that is exemplified through application of the common law principle of *nemo dat quod non habet*. Under this principle, a person who seeks to transfer an interest in property can do so only subject to a prior *in rem* interest in the property held by someone else. The term is used to distinguish this type of right from a right *in personam* that is enforceable against a person without regard to property interests. The importance of the distinction is not diminished by the fact that, under the common law, *in rem* rights in personal property, for the most part, are recognized in the form of a damages order obtained in a tort action.

³ For a detailed examination of the law of conversion in the context of Article 9 of the American *Uniform Commercial Code [UCC]*, see Steven Wechsler, “Rights and Remedies of the Secured Party After an Unauthorized Transfer of Collateral: A Proposal for Balancing Competing Claims in Repossession, Resale, Proceeds, and Conversion Cases” (1983) *Buff L Rev* 373; and Russell A Hakes, “A Quest for Justice in the Conversion of Security Interests” (1993-1994) 82 *Ky LJ* 837.

⁴ *PPSA*, *supra* note 1, s 28(1).

⁵ These features of current property tort law are examined in greater detail later in this article.

⁶ For example, the debtor under the security agreement may not be in default.

requirement has been met, however, an action can be brought against the transferee for recovery of damages even though the collateral could be seized from the transferee. The measure of damages recoverable in such an action is the market value of the collateral at the date of the transfer, even though the obligation secured by the security interest is less than this amount, and even though this amount could not be recovered by the secured party through seizure and sale of the collateral. The transferee is liable even if he or she did not know of the existence of a security interest in the collateral when it was acquired and could not have discovered the interest through a search of a personal property security registry. The secured party can recover for loss of the value of the collateral but not compensation for damage to it.

With one possible exception, traditional property torts are conceptually and, for the most part, functionally unsuited to address a range of important issues that may arise when a remedy other than seizure and sale of collateral by a secured party is required or appropriate. What is required is a new statutory cause of action that more accurately reflects the nature of security interests and the rights and obligations of persons who grant or acquire interests in collateral. It is difficult to demonstrate a pressing need for a new cause of action by pointing to existing Canadian case law. One may well conclude that conversion provides an adequate basis for a remedy in the “run of the mill” situation where the debtor is in default, the collateral has been disposed of by the debtor and cannot be seized by the secured party, and the obligation secured is equal to or greater than the value of collateral.⁷ Experience in the United States with statutory secured transactions law that, like its Canadian counterpart, does not address non-seizure remedies,⁸ is, however, a good indicator of the kinds of problems that Canadian courts can be expected to encounter in the foreseeable future.⁹

2. *Causes of Action*

While formal pleadings based on the forms of action were abolished over 160 years ago in England, it remains necessary to have a conceptual basis for civil legal proceedings that provides the sources of rules through which prohibited conduct is addressed and the sanctions associated with that conduct are determined. It is in this context that traditional forms of action have provided the legal structure within which interests in personal property are protected, primarily through a monetary award as damages. It

⁷ See e.g. *Paragon Properties (Finance) Ltd v Del Swan Trucking Inc.* [1999] 7 WWR. 224 (Alta QB), 68 Alta LR (3d) 165 [*Paragon Properties*].

⁸ See the UCC, Article 9 which has been enacted in all states.

⁹ See articles cited *supra* note 3.

is due to the lack of an appropriate alternative that security interests are protected – generally through monetary compensation— by proceedings that fall within the general category of property tort rather than a *sui generis* action focused on protection of this form of property right.¹⁰

A central feature of traditional property torts is their focus on possession or a right to immediate possession as an essential element. The result is that they fail to protect the property interests of persons who are not in possession at the time of loss or damage to those interests. Although it took a very long time for the courts to recognize the problem, the deficiency was ultimately addressed in the form of the “modern” action for damage to a reversionary interest in personal property.¹¹

The three long-established common law causes of action that address wrongful interference with possessory interests in personal property are trespass to goods, detinue and conversion. The *ad hoc*, uncoordinated way they developed has resulted in complexity, overlap and lack of clarity of principles on which they are based.¹² This has induced law reform agencies to recommend significant revision of the law relating to wrongful interference with chattels¹³ and the English Parliament to enact reform legislation.¹⁴ No Canadian legislature has implemented the recommended changes.

¹⁰ See generally Sarah Green and John Randall, *The Tort of Conversion*, (Oxford: Hart Publishing, 2009) at 5-36 and 54-58; Simon Douglas, *Liability for Wrongful Interference with Chattels* (Oxford: Hart Publishing, 2011) at 510-14.

¹¹ The first cases in which recovery was given under this category of tort occurred in the middle of the nineteenth century. See generally Andrew Tettenborn, “Reversionary Damage to Chattels” (1994) 53 Cambridge LJ 326. See also text accompanying notes 32-33, *infra*.

¹² The anomalies associated with property torts have long been recognized. In 1905, Sir John Salmond observed:

Thus if we open a book on the law of torts, however modern and rationalized, we can still hear the echoes of the old controversies concerning the contents and boundaries of trespass and detinue and trover and case, and we are still called upon to observe distinctions and subtleties that have no substance or justification in them, but are nothing more than an evil inheritance from the days when forms of action and of pleading held the legal system in their clutches.

John Salmond, “Observations on Trover and Conversion” (1905) 21 LQR 43. Little has changed in this respect since 1905.

¹³ Law Reform Commission of British Columbia, *Report on Wrongful Interference with Goods* (Victoria: Law Reform Commission, 1992); Ralph L Simmonds *et al*, *Study Paper on Wrongful Interference with Goods* (Toronto: Ontario Law Reform Commission, 1989; Law Reform Committee, *Eighteenth Report (Conversion and Detinue)* (London: HM Stationery Office, 1971).

¹⁴ *Torts (Interference with Goods) Act 1977* (UK), c 32.

A) *Trespass to Goods*

Trespass to goods is an action to recover loss resulting from direct interference (intentional or careless) with the claimant's actual possession of a chattel or from damage to chattels in the claimant's possession. Although the original action was trespass *de bonis asportatis* (a physical taking of the goods), it was ultimately extended to include physical damage to the goods. The action is available only to a possessor.¹⁵

Trespass can play only a very minor role in protecting the *in rem* rights of secured parties. A secured party in possession of goods can bring a claim against a third person only where the security interest has been perfected by possession¹⁶ or by attornment of a bailee.¹⁷ This form of perfection is used only rarely in modern financing except where the collateral is negotiable property. The remedy available to the claimant is recovery of the goods (and compensation for damage to the goods) or judgment for the value of the chattels.

B) *Detinue*

Detinue¹⁸ is as close to an *in rem* remedy as the common law provides in the context of rights in personal property.¹⁹ It is available to someone who was in possession or who has a legal proprietary interest (full or special) and an immediate right to possession of goods taken and detained by the defendant. The defendant must have refused to return the property following a demand by the claimant.²⁰ The action focuses in large part on the claimant's property interest and on the refusal of the defendant to surrender possession of the property in response to a demand by the claimant. Unlike conversion, it is the retention and not the taking that is the basis for the action. The usual remedy is an order of return of the goods to the claimant. It is this aspect that gives the action its proprietary character. The claimant can seek damages as an alternative. The action does not, however, address liability for damage to the goods or provide for a court order to return goods that are not in the possession of the defendant. The rules of court of many jurisdictions bar the common law right of the defendant to elect to keep the goods and pay to the claimant their value

¹⁵ Lewis Klar, *Tort Law* (Toronto: Thomson Carswell, 2008) at 88-90.

¹⁶ *PPSA*, *supra* note 1, s 24.

¹⁷ *Ibid*, s 27(1)(a)-(c).

¹⁸ Technically, *detinue sur trover*. However, the allegation of founding (trover) is non-traversable.

¹⁹ There is academic doubt as to where it is appropriate to treat detinue as a personal rather than as a property action; see Douglas, *supra* note 10 at 89-90.

²⁰ Klar, *supra* note 15, at 92-93.

assessed as of the date of the order.²¹ Nonetheless, return of the goods in response to the demand is a good defence.²²

The possibility of getting an order for recovery of property in a detinue action is not relevant in the context of the *PPSA* which gives to a secured party a statutory right to seize collateral and the opportunity to obtain a court order requiring a person in possession of it to deliver it to the applicant.²³ The alternative open to the claimant to seek recovery of the value of the collateral may not be advantageous to the secured party. Recoverable damages are determined on the basis of the value of the claimant's property at the date of the trial and not the date of the refusal to return the property.²⁴

Much of what was addressed in detinue came within the scope of the action in conversion largely because both remedies addressed interferences with possession. In England, detinue was subsumed in a new statutory tort of conversion in the *Tort (Interference with Goods Act) 1977*²⁵ which requires a demand for return of the property and an unequivocal refusal to comply.

C) Conversion

The “modern” action in conversion, a derivation of the action on the case in trover, consumed its parent and occupied much of the legal territory of its cousins, trespass and detinue.²⁶ It became the “workhorse” of the law to deal with an unjustifiable exercise of control of goods or negotiable instruments²⁷ in violation of the right of the possession or immediately right to possession of the claimant.

Conversion has often been described as a tort that protects “proprietary” or “ownership” rights.²⁸ This assertion is misleading and must be viewed in context. “Ownership” of tangible personal property at

²¹ See e.g. Saskatchewan *Queen's Bench Rules 2013*, Rule 10-27(1).

²² *Ibid.*

²³ See *PPSA*, *supra* note 1, ss 58 and 63.

²⁴ Klar, *supra* note 15 at 95.

²⁵ *Supra* note 14, s 3.

²⁶ See Law Reform Committee, *supra* note 13 at paras 7-10 and 16-19. It should not be assumed that the common law is clear on the distinct characteristic of each of these remedies.

²⁷ See *Boma Manufacturing Ltd v CIBC*, [1996] 3 SCR 727, 140 DLR (4th) 463.

²⁸ *GMAC v Osman Auction Inc* (1994), 150 AR 293 (QB); *Simpson v Gowers* (1981), 32 OR (2d) 385 (CA), 121 DLR (3d) 709; *CIBC v Fuscana Corp.*, [2004] 6 PPSAC (3d) 178 (Ont Sup Ct). However, in the latter two cases, the successful claimant had a right to possession as well as “ownership.”

common law is a relative concept. At best, it can be seen as comprising a spectrum or bundle of rights in and to personal property. As such, it does not exist in the form that can be analogized to a fee simple title to land. From early times, the principal proprietary right protected by the law was possession or immediate right to possession. Conversion remains as a remedy that protects “proprietary rights” to the extent that those rights arise out of possession or an immediate right to possession of personal property.²⁹ The lack of a clear concept of ownership of personal property at common law resulted in the development of an action in tort that focuses on the “wrong” of interference with the possessory rights of the claimant and not damage to the claimant’s property interest.³⁰ It protects the superior right to possess (a possessory title) of the claimant against intentional interference with that right in whatever form.

A claimant need not establish ownership in order to succeed in a conversion action. A finder who has been deprived of the possession of the property he or she has found may bring a successful conversion action against the defendant who interfered with the finder’s possession. However, conversion does not address situations where the claimant has all of the other aspects of “ownership” but does not have possession or an immediate right to possession at the time of interference by another person. Another cause of action – special action on the case for injury to a reversionary right – has this role.³¹ This action protects the interests of a “true owner” to whom the right to possession will revert at some future time once the possessory rights of someone else expire.

Conversion involves deprivation of the claimant’s possessory rights in their fullest form. It does not matter that the deprivation is temporary or that the defendant himself or herself took possession. As a strict liability tort, intention of the defendant to deprive the claimant of his or her possessory rights is not an element of the claimant’s case. The defendant can be liable even though he or she had an honest belief in his or her superior right to possess the property. Simple interference by the defendant with the claimant’s possession or right to possession is not sufficient, however. The claimant must establish that the tortfeasor exercised cognitive control of the property. He or she must have acted in such a way as to indicate his or her intention to exercise control of the property in a manner that is inconsistent with the claimant’s immediate right to

²⁹ Klar, *supra* note 15 at 96-98.

³⁰ The tort has been described as having a “hybrid jurisprudential nature;” see Green and Randall, *supra* note 10 at 168.

³¹ See, text accompanying notes 39-40, *infra*.

possession.³² In this respect, conversion differs from trespass which requires no such intention.

An action in conversion can be maintained even though the claimant suffered no loss as a result of the conversion (for example the converted property was surplus to the needs of the claimant and he or she had no intention of selling or using it).³³ *Prima facie*, the measure of damages recoverable from a converter is the market value of the property converted determined at the date of conversion and not the value of the claimant's interest in the property.³⁴ The defendant is deemed to have bought the converted property at that date. Payment of the award is treated as a purchase of the property by the converter. When the claimant has been only temporarily deprived of his or her possession or right to possession and has accepted the tortfeasor's offer to return the possession to the claimant, the claimant is treated as having bought the property back from the tortfeasor with the result that the measure of damages is the depreciation in value of the property during the period of the conversion and not the damages suffered as a result of not having possession during that period.³⁵ Loss through depreciation of the property falls on the tortfeasor even though the property would have similarly depreciated had the conversion not occurred. If the converted asset increases in value during the period of conversion, the increase is recoverable as consequential damages by the claimant.³⁶ Furthermore, the claimant can recover damages for loss of income from the property during the period of the conversion. However, since conversion is not an *in rem* remedy, recovery for damage to the property short of its destruction is not recoverable.

The deemed purchase approach to measuring damages in conversion assumes that the claimant is the "owner" of the property and not someone who merely had possession or the immediate right to possession of the property at the date of the conversion. Consequently, the defendant may

³² Klar, *supra* note 15 at 98-100; *Clow v Gershman Transport International Ltd*, 2000 ABQB 360, 82 Alta LR (3d) 196. There is a debate in the case law as to whether an auctioneer who sells goods as agent of someone else can be liable in conversion; see *Lloydminster Credit Union Ltd v 324007 Alberta Ltd*, 2011 SKCA 93 at para 37, (2011), 375 Sask R 179 [*Lloydminster Credit Union*].

³³ *The Mediana* [1900] AC 113 (HL).

³⁴ *National Trust Co v Saks* 51 ACWS (3d) 539, [1994] OJ No 2488 (Ont Gen Div) (QL); *Canada Trustco Mortgage Co v Cerilli Group Inc* (2005), 8 PPSAC (3d) 47 (Ont Sup Ct); *CIT Financial Ltd v Duesling*, 2012 ONSC 1315, 2012 CarswellOnt 2915 (Ont Sup Ct).

³⁵ *BBMB Ltd v Eda Holdings Ltd*, [1990] 1 WLR 409 (PC); Klar, *supra* note 15 at 95-96.

³⁶ *Sachs v Miklos* [1948] 2 KB 23 (CA).

not raise as a defence that a third person, a *tertius*, is the owner of the goods³⁷ if the goods were in the possession of the claimant at the date of the conversion. It is unclear whether a *jus tertii* can be raised in defence if the claimant had only a right to possession (as distinct from actual possession) at that date.³⁸

D) The “Modern” Action for Damage to a Reversionary Interest

A person who does not have an immediate right to possession (and consequently cannot bring an action in conversion or detinue) may bring an action on the case where his or her reversionary interest in the property is negatively affected as a result of the property being destroyed or transferred to a third party. The recoverable damages compensate for the actual loss suffered by the claimant.

By comparison to the other property torts, a reversionary damage action is of recent origins and one that is underdeveloped.³⁹ It gets only passing, almost dismissive treatment⁴⁰ in standard works on property torts. However, it addresses a significant *lacuna* in more traditional tort law – damage to the property rights of a person who is not in possession of the property and who, at the time of the act causing the damage, does not have a right to demand possession of it. As such, it provides a remedy in tort to a secured party in cases where his or her property interest is damaged or destroyed without the necessity to establish possession or the right to possession.

One expert has set out what the characteristics of this tort should be.⁴¹ The action should be available to anyone who has a property interest in goods that have been damaged or lost. The issue of *jus tertii* should create no problem given that what is involved is an action for damage to the claimant's property interest. So long as that interest is superior to the interest of the defendant, the fact that someone else has an interest superior to that of the claimant is not relevant. The limited interest of the claimant is reflected in the amount of damages recoverable from the defendant.

The relative novelty of the action for damage to a reversionary interest is both a benefit and a problem. It is a benefit in that the action is not

³⁷ This feature of the law of conversion is the source of considerable functional problems; see Law Reform Committee, *supra* note 13 at paras 58-78.

³⁸ Carolyn Sappideen and Prue Vines, eds, *Fleming's The Law of Torts*, 10th ed (Sydney: Lawbook Company, 2011) at 77-79.

³⁹ See generally Tettenborn, *supra* note 11.

⁴⁰ See e.g. Klar, *supra* note 15 at 97.

⁴¹ Tettenborn, *supra* note 11.

burdened by much of the conceptual baggage associated with the “old” torts. However, it is a problem because the tort remains under-developed with the result that its characteristics have yet to be fully fleshed out by the courts.

3. *The Rights of a Secured Party*

A) *The Nature of a Security Interest*

A *PPSA* security interest is *sui generis*; there is no direct equivalent to it in either law or equity.⁴² The essential nature and scope of a *PPSA* security interest and the implications to be taken from it are to be found in the Act and are circumscribed by rules endemic to its *raison d’être*. The *PPSA* makes it clear that a security interest, while *in rem* in nature,⁴³ is an accessory or dependent property right, and, consequently, a limited interest in personal property (the collateral). A secured party has only a part of the quantum of rights commonly referred to as ownership even in cases where the debtor held all of the elements of ownership at the date the security interest attached. The security interest is not based on a transfer of ownership by the debtor to the secured party.⁴⁴

The existence and scope of a security interest depend upon an obligation owing to the holder of the interest. Absent an obligation, the interest cannot exist notwithstanding an agreement providing for it. A security interest cannot be greater than the obligation it secures even if the value of the collateral exceeds the obligation.⁴⁵ By the same token, a

⁴² Under the “substance” approach contained in clause 3(1)(a) of the Act, transactions such as title retention sales agreements, security leases and security trusts that under prior law did not involve security interests are treated as ones in which the sellers, lessors or beneficiaries have security interests and not ownership or legal titles to the collateral. See generally Ronald CC Cuming, Catherine Walsh and Roderick J Wood, *Personal Property Security Law*, 2nd ed (Toronto: Irwin Law, 2012) ch 4.

⁴³ *PPSA*, *supra* note 1, s 2(1)(qq) defines a security interest as “an interest in personal property that secures payment or performance of an obligation . . .” The proprietary nature of a security interest was recognized by the Supreme Court of Canada in *Innovation Credit Union v Bank of Montreal*, 2010 SCC 47, [2010] 3 SCR 3.

⁴⁴ In this respect, it differs from a Section 427 security under the *Bank Act*, SC 1991, c 46, which involves transfer of legal title to the secured party bank; see *Royal Bank of Canada v Sparrow Electric Corp*, [1997] 1 SCR 411, 143 DLR (4th) 385.

⁴⁵ Any portion of an obligation that is discharged through bankruptcy cannot be secured by the debtor’s acquisition of property or increase in value of the debtor’s property after the discharge. See Tamara M Buckwold, “Post-Bankruptcy Remedies of Secured Creditors: As Good as it Gets” (1999) 31 Can Bus LJ 436; *Holy Rosary Parish (Thorold) Credit Union Limited v Danny Bye*, [1967] SCR 271, 61 DLR (2d) 88; *Patrie v Royal Bank of Canada* (1994), 27 CBR (3d) 89 (Ont Gen Div).

security interest cannot be greater than the value of the collateral even though the obligation owing by the debtor to the party is greater than this value. The principal role of a security interest is to place the holder in a better legal (and commercial) position than it would occupy as a simple unsecured creditor. Unlike an unsecured creditor, a secured creditor who has a security interest that is perfected at the date of the debtor's bankruptcy is entitled to enforce its secure interest against the property of the bankrupt that is collateral. Essentially, a secured party can look to the collateral as an alternative or supplementary source of value that is applied to complete or partial discharge of the obligation the debtor. The remedies available to the secured party, other than those associated with the party's *in personam* contract rights,⁴⁶ are those specified in the Act and should be those that by implication are associated with the special nature of a security interest as an *in rem* interest in personal property.

B) Enforcement – Seizure and Sale or Collection of Collateral

Part V of the *PPSA* sets out in great detail secured parties' enforcement rights against collateral. Sections 58 and 59 provide the principal mechanism through which the *in rem* interest of a secured party in tangible collateral is converted into money to be applied to the obligation it secures: seizure and sale of the collateral.⁴⁷ Section 58(2)(a) provides that “[s]ubject to any rule of law requiring prior notice, on default under a security agreement, the secured party has, unless otherwise agreed, the right to take possession of the collateral or otherwise enforce the security agreement by any method permitted by law.” Section 59 sets out the right of the secured party to sell or otherwise dispose of the collateral. The power to seize tangible collateral, however, is not the core of a security interest. The interest exists independently of the secured party's right to possession provided by section 58 and the secured party's possession acquired by seizure.

Clause 2(1)(n) of the *PPSA* defines “default” as failure to pay or perform the obligation secured when due and any other event or set of circumstances on which, pursuant to the terms of the security agreement, the security interest becomes enforceable. This gives considerable scope to the parties to specify in the security agreement what constitutes default on the part of the debtor. An event of default does not necessarily entitle the secured party to seize the collateral, however. Section 58 sets as a

⁴⁶ The right to bring action on the contract is recognized by the *PPSA*, *supra* note 1, s 56(2)(a)(i). However, this may be subject to restrictions or prohibitions contained in other legislation. See Cuming, Walsh and Wood, *supra* note 42 at 655-56.

⁴⁷ Where the collateral is an account or a payment obligation arising under chattel paper, an instrument or a security, the secured party enforces the security interest by demanding payment from the obligor; see *PPSA*, *ibid*, s 57.

precondition to seizure compliance on the part of the secured party with “any rule of law requiring prior notice.” Consequently, default as defined in the Act or in the security agreement by itself does not trigger the right of seizure. This right may not be legally exercised without giving the debtor the common law pre-seizure notice (which may entail delay in seizure)⁴⁸ and until the expiry of the period of time specified in section 244 of the *Bankruptcy and Insolvency Act*.⁴⁹ Furthermore, a secured party’s right of seizure may be temporarily or permanently stayed as provided in the *Companies’ Creditors Arrangement Act*⁵⁰ or the *Bankruptcy and Insolvency Act*.⁵¹ However, these procedural impediments do not affect the *in rem* rights of secured creditors.

C) Enforcement Against Non-debtors – The PPSA Priority Regime

A feature of the *in rem* nature of a security interest is the priority status it may have in relation to other interests in the collateral. In some contexts, this status is based on the fundamental property rule of the common law: *nemo dat quod non habet*. A buyer of collateral acquired out of the ordinary course of business of the seller (debtor) takes subject to a perfected security interest in it.⁵² A trustee in the debtor’s bankruptcy takes subject to a perfected security interest in property of the debtor that vests in the trustee.⁵³ Not all aspects of the priority regime of the *PPSA* are based on the *nemo dat* principle. Other rules prescribe priority outcomes based on factors other than the date the competing interests in the collateral arose.⁵⁴ However, under all of these rules, it is a property interest that is given priority. It is not possible for a buyer,⁵⁵ judgment creditor⁵⁶ or trustee

⁴⁸ *Ronald Elwyn Lister Ltd v Dunlop Canada Ltd*, [1982] 1 SCR 726, 135 DLR (3d) 1; *Mister Broadloom Corporation (1968) Ltd v Bank of Montreal (1969)* (1979), 25 OR (2d) 198, 101 DLR (3d) 713 (HC).

⁴⁹ RSC 1985, c B-3. For an examination of the “reasonable notice doctrine” and section 244 of the *Bankruptcy and Insolvency Act*, see Cumming, Walsh and Wood, *supra* note 42 at 623-31.

⁵⁰ RSC 1985, c C-25, s 11.02.

⁵¹ *Supra* note 49, ss 69(1), 69.1 and 69.2.

⁵² *PPSA*, *supra* note 1, s 28.

⁵³ *Ibid*, s 20(2); *Bankruptcy and Insolvency Act*, *supra* note 49, s 71.

⁵⁴ For example, under *PPSA*, *ibid*, s 35(1), priority is determined on the basis of the date of registration; and under s. 34, priority is determined on the basis of the circumstances in which the security interest came into existence.

⁵⁵ See *Royal Bank v 216200 Alberta Ltd*, [1987] 1 WWR 545, 51 Sask R 146 (CA).

⁵⁶ See *The Enforcement of Money Judgments Act*, SS 2010, E-9.22, sections 22-23, which provide that registration of a money judgment gives rise to an enforcement charge affecting the exigible personal property of the judgment debtor that has the same priority status as a *PPSA* security interest. Similar status is given to registered money judgments under judgment enforcement legislation of other provinces.

in bankruptcy to have priority to collateral under the *PPSA* without having an *in rem* interest or a statutory equivalent in the collateral.

There are only peripheral references in Part V of the Act to the exercise of the enforcement against someone other than a debtor.⁵⁷ However, a necessary corollary of the priority regime of the Act is that, upon default by the debtor, a secured party with a security interest can exercise enforcement rights against the collateral in priority to the rights of other claimants with interests in the collateral that have a lower priority status. One of the methods of enforcement available to a secured party who, under the priority rules of the Act,⁵⁸ has higher priority is seizure and sale or collection of the collateral from a transferee of the debtor,⁵⁹ a sheriff enforcing a judgment against the debtor by seizure of the collateral, the debtor's trustee in bankruptcy⁶⁰ or a secured party who has seized the property.⁶¹

D) Non-Seizure Remedies

The *PPSA* provides a legal structure for the creation, priority and enforcement of a special purpose *in rem* right in personal property. Other than incorporation of the "principles of the common law, equity and the law merchant" as default sources,⁶² however, the Act says nothing about the non-contractual rights of secured parties against debtors or other persons in cases where enforcement against the collateral is not possible because the collateral has been destroyed, cannot be found or, for any other reason, cannot be seized. Nor is there any statutory remedy when the collateral has been damaged or has experienced inordinate depreciation prior to seizure. Furthermore, the Act does not address the situation where, for any reason, the secured party decides to seek a remedy that does not involve looking to the collateral as a source of money to discharge the obligation secured. In almost all cases,⁶³ given the accessory nature of a security interest, the secured party has an *in personam* right of action

⁵⁷ This is so since the primary policy basis of Part V is the protection of interests of defaulting debtors. However, ss 61 and 62 provide some protective measures to specified third parties.

⁵⁸ Other statutory regimes that give priority to claimants to the collateral may result in loss of enforcement rights by the secured party; see e.g. *The Commercial Liens Act*, SS 2001, c C-15.1, s 11.

⁵⁹ *PPSA*, *supra* note 1, ss 10, 28.

⁶⁰ *Ibid*, s 20(2).

⁶¹ If the value of the collateral is equal to or less than the obligation secured, subordinate interests in the collateral are extinguished; see *ibid*, ss 59(14).

⁶² *Ibid*, s 65(2).

⁶³ This right may be extinguished or precluded by other statutory provisions; see discussion *supra* note 46.

against the debtor based on the contract that gave rise to the obligation. This is not available, however, where a remedy is being pursued against a person with whom the secured party has no contract. In cases of this kind the secured party's remedy must be provided by law other than the *PPSA*. As noted above, the prevailing view is that property tort law, and, in particular, the law of conversion, provides the legal structure (the cause of action) through which the secured party can obtain a remedy – in most cases damages — for loss of or damage to his or her *in rem* interest in the collateral.

4. Conversion as a Source of Remedies for Secured Parties

A) The Problems with Conversion – Conceptual Asymmetry

Conversion is both conceptually and functionally ill-adapted as a remedy for violation of a person's *in rem* rights in the form of a security interest in collateral. Not only does the conceptual basis of conversion fail to accommodate the essential nature of a *PPSA* security interest,⁶⁴ but, in addition, application of the remedy in the context of secured transactions law can produce results that are anomalous and commercially unacceptable.

There is superficial symmetry between the conceptual basis for conversion and the procedural rights of a secured party. As noted above, the principal method of enforcing a security interest in tangible property is seizure and sale of the collateral by the secured party. In this respect, it is tempting to draw a parallel between the immediate right to possession of a claimant in a conversion action and the statutory right of a secured party to seize the collateral in the event of default by the debtor. A facile conclusion is that it is a secured party's statutory right to possession that is protected by an action in conversion.⁶⁵ What this ignores, however, is that rights associated with a security interest are not possessory in nature, though they may be asserted by means of a statutory procedure that involves seizure when tangible collateral is involved.

⁶⁴ In *Lloydminster Credit Union*, *supra* note 32 at para 37, Jackson J of the Saskatchewan Court of Appeal noted the uneasy juxtaposition of the law of conversion and secured transactions law.

⁶⁵ See e.g. *Paragon Properties*, *supra* note 7. See also *Lloydminster Credit Ltd. v. 320047 Alberta Ltd.* 2009 SKQB 454, [2010] 8 WWR 184. On appeal, Jackson J raised, but found it unnecessary to address, the issues (i) whether, and in what circumstances, a secured creditor must give notice to a debtor and (ii) the effect of such an obligation on a secured creditor's ability to assert an immediately right to possession so as to be able to claim against another for the conversion of the collateral; see *Lloydminster Credit Union*, *supra* note 32 at para 37.

A security interest is an *in rem* interest in the collateral the conceptual basis of which is not possession. The *PPSA* right of seizure is not *the sine qua non* of a security interest. A security interest exists independent of this right. A secured party's proprietary interest in collateral can be violated or damaged in ways other than through interference with the secured party's statutory right of seizure. Conversely, interference with the statutory right of seizure and sale does not result in the loss of the interest; it merely disrupts or makes it impossible to invoke one of the mechanism through which the interest is converted into money to be applied to the obligation secured.

The statutory procedural right given to a secured party is qualitatively different from the right to possession that is protected by a conversion action. It is nothing more than an initial step in the process of enforcement. The secured party who has seized collateral in accordance with the requirements of the Act has a right to "custody" of the collateral but not a right to possession in the sense of having use and enjoyment of it – the kind of possession that the common law treated as the most important aspect of the bundle of rights cumulatively referred to as ownership.⁶⁶ Section 17 of the Act demonstrates the limited nature of a secured party's possession rights in collateral.⁶⁷ The secured party must "use reasonable care in the custody and preservation of the collateral" in its possession.⁶⁸ This statutory obligation, along with the conceptual nature of a security interest, provides unequivocal recognition that the collateral is not to be treated as that of the secured party. The secured party is not entitled to the fruits of seized collateral but must account for any increase or profit from the collateral.⁶⁹ If the agreement so provides, the secured party may use the collateral but only in a manner that is consistent with the requirements of reasonable care and preservation and with the property rights of the debtor

⁶⁶ *PPSA*, *supra* note 1, s 60 provides a procedure under which the debtor, in response to a proposal by the secured party who has seized the collateral, agrees that the secured party will take the collateral in full satisfaction of the obligation secured. Other persons with interests in the collateral may prevent this from occurring. The opportunity to retain the collateral is not, however, a feature of the secured party's right to seize it and is not an essential feature of a security interest. The opportunity arises only when the debtor agrees (and other persons with interests in the collateral by implication consent) to the secured party's proposal.

⁶⁷ While no doubt section 17 applies to post-seizure possession, its primary function is to address the extent of a secured party's rights and obligations with respect to collateral transferred to his or her possession as a perfection step as provided in section 24 (i.e., a pledge under pre-*PPSA* law). Its application in a post-seizure context is necessarily limited by the express and implied constraints of Part V of the Act.

⁶⁸ *PPSA*, *supra* note 1, s 17(2).

⁶⁹ *Ibid*, s 17(3)(c).

or the holder of a subordinate interest in the collateral. The right to use the property is not an incident of possession; it must be contractually granted.

Not only is a secured party subject to significant constraints on use of seized collateral but there is an implicit limit on the duration of its possession. A secured party's attempt to retain possession of seized collateral for a period longer than is consistent with the exercise of Part V enforcement steps (except when the debtor has surrender of his or her interest in the collateral in accordance with section 61),⁷⁰ would violate the underlying policy of Part V and, at least, subject the secured party to a court order requiring sale of the collateral.⁷¹ Furthermore, a secured party's possession resulting from seizure can be truncated or terminated by an offer of reinstatement as provided in subsection 62(1)(b).

B) Functional Problems with Conversion in a PPSA Context

A successful claimant in a conversion action has the right to refuse to accept surrender of the property by the converter, at least when the offer of return is not made promptly or when the property cannot be returned in the same condition as it was when it was converted. The claimant is entitled to a judgment for damages equivalent to the full market value of the property at the date of the conversion.

It is implicit in the *PPSA* priority structure that the secured party may seize the collateral in the hands of a transferee.⁷² This, not an action in conversion to recover the market value of the collateral, is the appropriate remedy in cases where no significant damage has been done to the secured party's interest in the collateral and seizure of it is possible. Even in cases where an item of collateral has been damaged or seizure is not possible or commercially realistic, it is not inevitable that the value of the security interest is equal to the market value of the collateral at the date the transferee obtained possession of it. The secured party may have been "over-secured" if the value of all the collateral covered by the security agreement is in excess of the obligation secured. The debtor may have discharged a significant portion of the obligation through payments made to the secured party but there may be no commensurate reduction in the value of the collateral. The secured party's interest in the collateral may be small or non-existent because the collateral is subject to a prior security interest securing an obligation that is equal to or substantially equal to its value.

⁷⁰ See discussion *supra* note 66.

⁷¹ *PPSA*, *supra* note 1, s 63(2).

⁷² *PPSA*, *ibid*, s 58(2), which provides for the right of seizure, does not limit this right to seizure from the debtor.

In order to address the anomalous conclusion that a claimant who has nothing more than possession or a right to possession can recover the full market value of the converted property, the courts have concluded that the claimant who is paid this amount must account to persons who also have *in rem* interests in the property converted.⁷³ There is no explicit link, however, between what the court orders in the conversion action and the *PPSA* priority rules. The accounting may require determining the priority status of several other claimants to the money paid by the converter. Furthermore, there is nothing to prevent the holder of a security interest that has priority over that of the claimant from ignoring the court-ordered accounting and bringing a separate action for conversion of its interest.

A more commercially realistic approach has been applied by courts not willing to accept the rigidity and apparent injustice of the converter-as-buyer approach in awarding damages in conversion actions. In English cases⁷⁴ where the defendant converted property initially acquired under a financial leasing arrangement (hire-purchase agreement), the court refused to give judgment in favour of the owner of the property for the full market value of the property where the lessee-buyer (hirer) had paid a significant portion of the purchase price (hire payments). The owner recovered only the actual amount of its loss which was the undischarged portion of the hirer's obligation. The approach in these cases is not viewed, however, as a universal change in a fundamental feature of the assessment of damages in conversion actions.⁷⁵ They address narrow situations in which the claimant was the owner of the converted property. There is no authority for application of the approach to a situation in which the claimant is a secured party with a limited interest in the collateral.

C) The Role of the Right to Redeem in a Conversion Action

An important conflict of applicable law will arise if a secured party brings an action in conversion against a transferee or subordinate secured party in possession of the collateral who, in response, exercises his or her statutory right of redemption. Clause 62(1)(a) of the *PPSA* gives to persons "entitled to receive a notice of disposition" of the collateral by a secured party, the right to "redeem the collateral by [] tendering fulfillment of the obligations secured by the collateral" and the secured party's seizure costs. Section 59(6) of the Act provides that a notice of intention to sell the collateral

⁷³ *The Winkfield* [1902] P 42 at 54-55; *Tomlinson v. Hepburn* [1966] A.C. 451 at 467-68 and 480.

⁷⁴ *Wickham Holdings Ltd v Brooke House Motors Ltd*, [1967] 1 WLR 295 (CA); *Belvoir Finance Co Ltd v Stapleton*, [1971] 1 QB 210 (CA).

⁷⁵ In *Green and Randall*, *supra*, note 10 at 186-87, the cases are treated as "exceptions to the basic rule."

must be given to (i) the debtor or any other person who is known by the secured party to be the owner of the collateral; (ii) a person with a subordinate security interest in the collateral who has registered or has taken possession of the collateral prior to the proposed date of disposition set out in the notice; and (iii) any other person with an interest in the collateral who has given a written notice to the secured party of that person's interest prior to the date on which the notice of disposition is given to the debtor. A subordinate secured party is in category (ii) and a transferee of collateral is in category (iii).

The right of redemption can be exercised any time before the secured party has disposed of the collateral or contracted for its disposition.⁷⁶ A person falling within one of the categories set out in section 59(6) may refuse to comply with a demand from the secured party to surrender the collateral but as an alternative offer to redeem the collateral as provided in the Act. In technical terms, a refusal of a transferee of the collateral to surrender it in response to the demand in any other context would amount to conversion.⁷⁷ The exercise of a statutory right of redemption cannot, however, be tortious. This right may be exercised by "tendering fulfillment of the obligations secured."⁷⁸ If the secured party's interest in the collateral is limited because there are other prior interests in the collateral or because the debtor has discharged a significant portion of the obligation, the amount that must be tendered is not likely to be the market value of the collateral at the date of its transfer to the defendant. Implicit in the concept of redemption is the right of the person exercising the right to require discharge of the security interest and, consequently, terminate the right of the secured party to seize it.

5. *A Statutory Solution*

A) Of Silk Purses and Sows' Ears

The traditional property torts of trespass, detinue and conversion cannot be relied upon to provide an adequate source of remedies to address loss or damage to secured parties' interests in collateral. It is not possible to

⁷⁶ *PPSA*, *supra* note 1, s 62(1)(a).

⁷⁷ There is strong argument that, by itself, mere acquisition of the collateral from the debtor cannot be conversion. Subsection 33(2) of the *PPSA* provides that the "rights of the debtor in collateral may be transferred consensually." The receipt of the collateral under a transfer from the debtor is sanctioned by the provision with the result that it cannot amount to conversion. The same analysis applies to seizure of the collateral by a subordinate secured party. Clause 58(2) gives to any secured party the right to seize the collateral in the event of default by the debtor.

⁷⁸ *PPSA*, *supra* note 1, s 62(1)(a).

develop a coherent structure by marrying sixteenth century tort remedies (replete with anomalies) to a modern secured transactions regime. The conceptual and functional confusion endemic to the property torts in their contemporary forms, accompanied by the lack of an appropriate interface with the *PPSA*, leaves a great deal of uncertainty in current law and conflicts with the fundamental policy of the *PPSA* – the reduction in legal risk by increasing predictability associated with secured transactions involving security interests in personal property.

It is the view of the author that it would be a mistake to rely on further judicial refinement of the action for damage to a reversionary interest as a basis for secured parties' remedies in cases where seizure and sale of collateral is inadequate or not possible. The uncertainty associated with the remedy makes it ill-suited to supplement a system designed to facilitate legal predictability. The full delineation of the features of this remedy must await further judicial amplification. What is required is a new statutory remedy that offers predictability through clear rules that reflect the characteristics of security interests and the relationship that arises out of secured financing arrangements where personal property is taken as collateral.

B) Basic Remedy – Seizure or Collection of Collateral

The conceptual structure on which secured transactions under the *PPSA* are based involves the statutory recognition that an obligor (debtor) and an obligee (secured party) may through agreement provide that the secured party acquires a statutory *in rem* interest in property of the obligor (or a third party guarantor or indemnitor) that secures performance of the obligation. The principal *raison d'être* of the *in rem* interest is to provide an alternative source of value to compensate the secured party should the debtor fail to discharge the obligation.⁷⁹ Upon default by the debtor and compliance with any pre-seizure notice requirement, the secured party is entitled to enforce the statutory rights associated with the *in rem* interest through seizure and sale of tangible property or collection of intangible property in the form of money from any person whose interest in it is subordinate to that of the secured party under the priority rules of the Act.⁸⁰

Since seizure is the principal remedy available to a secured party, a precondition to recovery of damages should be evidence that the secured party took commercially reasonable measures to seize the collateral. In

⁷⁹ In addition, the threat of seizure of the collateral can have *in terrorem* value of encouraging the debtor to avoid default and loss of the collateral.

⁸⁰ A secured party's right to bring action against the debtor on the contract, where allowed by applicable law, is always an alternative to seizure of the collateral.

most cases, this will involve a demand for surrender of possession of the collateral that has been met with a refusal to comply by the person in possession of it or evidence that such person is not able to comply. Endemic to this requirement is the issue whether the secured party should be required to invoke court involvement when the person in possession of the collateral is able but refuses to comply with a demand for surrender. While the court may require the defendant to pay these costs or order that they be treated as an aspect of the obligation secured, there is no assurance that they will be recovered by the secured party.

C) A Cause of Action for Damage or Destruction of Collateral

There will be circumstances in which seizure of the collateral is not a remedy that a secured party can exercise, or in which the collateral that can be seized has been damaged or has substantially depreciated in value while in the possession of a transferee. A necessary implication of the *in rem* interest of the secured party in the collateral is the right of the secured party to recover compensation for damage or destruction of the collateral or for loss that results when seizure of the collateral is functionally impossible or commercially impracticable due to the acts of others. Accordingly, it is important to provide to a secured party a remedy in damages that takes the place of seizure or compensates the secured party for loss in value of collateral that it is able to seize. The remedy should be a substitute for seizure only when this is not possible or not commercially practicable. Otherwise it should supplement seizure where the collateral has been damaged or has substantially depreciated while in the possession of the defendant.

Any new statutory remedy in the nature of an action for damages that compensates for damage to or loss of a secured party's *in rem* interest in collateral should focus on the property interest of the secured party that has been affected – the fact of damage to the collateral⁸¹ or loss of its value to the secured party as a result of inability to seize it.⁸² It should not be based on the act of interfering with a statutory right to possession (through seizure) of the property. For the most part it should not be fault based although it should not provide for strict liability.

D) The Secured Party's Interest

The amount recoverable should not exceed the amount of the obligation secured.⁸³ This amount should be reduced by any insurance proceeds

⁸¹ See *infra* draft provision (12).

⁸² See *infra* draft provision (10).

⁸³ See *infra* draft provisions (11) and (13).

payable to the claimant and payments made by a guarantor or indemnitor.⁸⁴ Furthermore, the recovery should also reflect the monetary value of the claimant's interest in the collateral. If the claimant has only a subordinate interest in the collateral, the value of the claimant's interest in the collateral is affected by the monetary value of any prior interest.⁸⁵ If the value of the collateral is equal to or less than the obligation owing to the holder of a prior interest, the claimant will have suffered no loss.

Where the collateral is one or more items that are part of a larger quantity of items or kinds of collateral subject to the security interest, the amount of recovery should be the extent to which the secured party would have been required to rely on the items of collateral that cannot be seized or that have been damaged to secure the obligation. If the balance of the collateral is sufficient to fully secure the obligation, no recovery should be allowed.⁸⁶ An assessment of the value of the balance of the collateral should take into account potential depreciation in that value during the balance of the agreement. The circumstances may be such that the court concludes that it is commercially unreasonable to require the secured party to rely on the remaining collateral.

E) Damage to or Loss of Collateral

An important aspect of the quantification of damage to or loss of a secured party's interest in collateral is the determination as to when the loss occurred. A refined approach would take into consideration the extent to which the collateral has or is likely to have depreciated in value while it is in the hands of the debtor. This is loss that would have occurred whether or not the collateral had been transferred to the defendant. Where an action is brought against the debtor for damage to or loss of tangible collateral, normal depreciation in the value of the collateral should not be recoverable.⁸⁷ Where the action is brought against someone other than the debtor, however, it is a reasonable assumption that the transfer of the collateral to that person is an event that would give to the secured party a right to seize and sell the collateral. This being the case, it is reasonable to measure the loss suffered by the secured party by comparing the value of the claimant's interest in the collateral at the date the defendant obtained possession of it with its value at the date of seizure.⁸⁸ If seizure is not

⁸⁴ See *infra* draft provisions (17)(b) and (c) A guarantor who honours an obligation under a guarantee contract should be subrogated to the rights of the secured party against the debtor; see *infra*, draft provision (20).

⁸⁵ See *infra* draft provisions (11) and (13).

⁸⁶ See *infra* draft provision (9).

⁸⁷ See *infra* provision (8).

⁸⁸ See *infra* draft provision (13)(a).

possible (or required) the recovery should be the value of the claimant's interest in the collateral at the date the defendant acquired possession of it.⁸⁹

F) The Role of the Defendant's Actual or Deemed Knowledge

Mere sale or other disposition of the collateral by someone (B1) who acquired it from the debtor in a non-ordinary course transaction,⁹⁰ without more, does not result in damage or destruction of the collateral and should not give rise to liability other than for depreciation of the collateral⁹¹ when it is B1's possession.⁹² He or she is merely passing on to the transferee (B2) the interest he or she acquired from the debtor. If B1 is aware or should reasonably have been aware when effecting sale or disposition that the collateral it is likely to be damaged, destroyed or made unavailable to the secured party as a result of the sale or disposition it, he or she should be liable to the secured party for the foreseeable loss of or damage to the collateral that occurred after the transfer to B2.⁹³

Similarly, if it is established that B2 was aware or reasonably should have been aware that by selling the collateral to a transferee (B3) there is a real risk that it would be damaged, destroyed or handled in such a way by B3 that it could not be recovered, B2 should be liable to the secured party.⁹⁴ But this is so only if he or she had actual or deemed knowledge of a secured interest in the collateral. B2 could not be deemed to know of the security interest if the only search criterion available to him or her is B1's name. A search using this criterion would not reveal the security interest. However, if the collateral is serial numbered goods and a valid registration required the inclusion of the serial number, B2 would have available a search criterion that would reveal the security interest.⁹⁵

The same reasoning applies with respect to liability of a transferee other than B1 for damage to the collateral in the form of depreciation during the time the transferee is in possession of it.⁹⁶ The transferee has no

⁸⁹ See *infra* draft provision (11).

⁹⁰ A sale in the ordinary course of business of the debtor results in termination of the security interest in the collateral and loss of any claim against the transferee so long as the requirement of *PPSA* s 30(2) have been met.

⁹¹ See *infra* provision (1) definition of "damage."

⁹² See *infra* draft provisions 12(a) and 13(a).

⁹³ See *infra* draft provisions (10)(d) and (12)(b).

⁹⁴ *Ibid.*

⁹⁵ See *infra* draft provision (15). For a description of role of serial numbers as search criteria, see Cuming, Walsh and Wood, *supra* note 42 at 331 and 349-52.

⁹⁶ See *infra* draft provision (15).

reason to conclude that, by using the collateral, he or she is violating the property rights of a secured party.

The position of subordinate secured party (SP2) who has seized and sold the collateral is different from that of B1 or B2. SP2 is able to determine through information obtainable from SP1 that the debtor is in default under the SP1-debtor security agreement. SP2 will be aware that a disposition of the collateral without prior notification to SP1 is likely to increase the cost and difficulty of SP1 associated with the exercise of SP1's right of seizure. This being the case, SP2 should be liable for any additional costs or loss incurred by SP1 in effecting seizure that are attributable to the disposition of the collateral by SP2 if a pre-disposition notice is not given to SP1 by SP2.⁹⁷

G) The Redemption Issue

As noted above, the *PPSA* gives to specified persons the right to "redeem" collateral by tendering fulfillment of the obligation secured by the collateral.⁹⁸ Exercise of this right should be an effective defence in an action against such a person. So long as the secured party is compensated by payment equal to the amount payable by a person who could redeem the collateral if it had been seized by the secured party, there can be no loss suffered by the secured party and no action against such person should succeed.⁹⁹

H) Class Action

When an action is brought by a secured party who has a subordinate or otherwise limited interest in the collateral, the amount recoverable by the claimant should be limited to the market value of that person's interest. In order to avoid multiplicity of proceedings, the action should be deemed to be an action on behalf of all identifiable parties who have interests in the collateral that have priority over the interest of the defendant.¹⁰⁰ If the action is successful and an award is made by the court for recovery of the value of destroyed or unrecoverable collateral, the court will allocate the amount payable by the defendant in a manner that reflects the various interests in the collateral.¹⁰¹

⁹⁷ See *infra* draft provision (14).

⁹⁸ See discussion above in Part 4 (C), "The Role of the Right to Redeem in a Conversion Action."

⁹⁹ See *infra* draft provision (18).

¹⁰⁰ See *infra* draft provision (6).

¹⁰¹ See *infra* draft provision (7).

I) Collection Rights under Intangibles or Chattel Paper

Subsection 57(2)(a) of the *PPSA* provides that a secured party is entitled to collect payment from a debtor on an intangible or chattel paper or from an obligor under an instrument or security. This will commonly arise where the collateral is an account and the secured party seeks to enforce its interest in the account by demanding payment of the account from the account debtor.¹⁰² Implicit in subsection 57(2)(a) is the rule of assignment law¹⁰³ that the assignee is entitled to enforce payment through an action against the account debtor. The Act does not, however, deal with the position of the account debtor where there is more than one interest in the account. While the account debtor could discover through a search of the registry the existence of other transferees of the account, there is nothing in the Act that obligates the account debtor to ensure that priority rights prescribed by the Act are recognized by directing payment to the secured party with the highest priority. On its face, subsection 57(2) suggests that the account debtor is entitled to respond to the first demand for payment from a secured party. This problem did not arise under pre-*PPSA* law. Both the right to priority and the obligation of the account debtor to make payment was determined on the basis of the rule in *Dearle v Hall*.¹⁰⁴ Under this rule, the account debtor was obligated to make payment to the first assignee to give him or her notice of the assignee's interest in the account. The notice was also the basis on which priority was determined so long as the assignee giving the notice was not aware of the prior assignment when the notice was given. Priority under the *PPSA* is not based on notice to the account debtor.

It is open for a court to conclude that a remnant of *Dearle* has been implicitly retained in the *PPSA* system. The account debtor who has not been notified of competing interests in the account is entitled to respond to the first or only demand he or she receives, and need not be concerned about of the priority status of the interest represented by that demand. This approach would be consistent with that prescribed by subsections 41(7) and (8) that address the obligation of the account debtor with respect to payment to the debtor (assignor) or secured party.¹⁰⁵

¹⁰² While the provision addresses collection based on an interest in any type of intangible or in chattel paper, an instrument of a security, the commentary has been confined to collection of an account.

¹⁰³ See e.g. *The Choses in Action Act*, R.S.S. 1978, c C-11, s 2.

¹⁰⁴ (1828) 3 Russ 1; [1828] 38 E.R. 475 [*Dearle*].

¹⁰⁵ Subsection 41(7) provides that an account debtor may make payment to the assignor (debtor) before he or she receives notice of a security interest in the account that contains details of the interest of the secured party. Subsection 41(8) provides that such payment discharges the obligation of the account debtor.

In any event, a secured party who has a superior priority to the account should have an action against the holder of an inferior right to it who has received payment from the account debtor.¹⁰⁶ It is very likely that under current law a successful action for unjust enrichment (money had and received) could be brought by the secured party with the superior priority. This action is categorized by experts on the law of unjust enrichment as involving “interceptive subtraction.”¹⁰⁷ However, a specific statutory cause of action would resolve the apparent uncertainty in this area of the law.¹⁰⁸

J) Proposed Statutory Formulation of the Remedy

(1) In this section:

“destroyed” in relation to an item of collateral means that the item cannot be used for any of the purposes for which it was designed without effecting repairs the cost of which is greater than seventy-five percent of the market value of the item;

“commercially unreasonable to seize” means that the cost of seizure of collateral is disproportionate to the value of the collateral;

“damage” includes depreciation in market value of the collateral while it is in the possession of the defendant;

“possession” includes control;

“secured party” includes a receiver;

“transferee” includes a secured party except as otherwise provided.

(2) A secured party may bring an action as provided in this section for the recovery for destruction of or loss or damage to collateral.

(3) No action may be brought by a secured party against a debtor or transferee of collateral for recovery of loss or destruction of or damage to the collateral, except as provided in this Act or any other Act.

The effect of this provision is to preclude an action by a secured party based on any of the traditional property torts including an action in negligence. Where collateral has been damaged or destroyed as a result of negligent conduct on the part of the debtor, an action as provided in provision (10) or (12) could be brought by the secured party.

¹⁰⁶ See *infra* draft provision (19).

¹⁰⁷ See Charles Mitchell, Paul Mitchell and Stephen Watterson, eds, *Goff & Jones: The Law of Unjust Enrichment*, 8th ed (London: Sweet & Maxwell, 2011) at paras 6-52 to 6-62.

¹⁰⁸ *Ibid.*

(4) Nothing in this section precludes an action for conversion of a negotiable instrument.

(5) Subject to provision (6), the amount recoverable in an action under this section shall not exceed the monetized obligation or obligations secured by the security interest in the collateral.

The provision outlined in section 5 states a core principle of the *PPSA*. The value of a secured party's security interest in collateral can never exceed the monetized value of the obligation it secures.

(6) Unless the court orders otherwise, an action under this section shall be deemed to be an action on behalf of:

(a) all persons who are known by the secured party to have property interests in the collateral; and

(b) a person who has effected a registration in a public registry relating to an interest in the collateral.

(7) For the purposes of provision (6) a reference in this section to "secured party" is to each person referred to in that provision, and a reference to "damages recoverable" refers to the damages relating to the interest of each such person.

Provisions (6) and (7) address situations in which the damage or destroyed collateral is subject to more than one interest and the loss has been suffered by each interest holder in appropriate proportions depending upon their relative priority.

(8) No action may be brought under this section by a secured party against a debtor for damage to collateral in the form of normal depreciation in the market value of the collateral.

The provision reflects the practical reality that the parties to a security agreement recognize that the collateral will experience normal depreciation when it is in the possession of the debtor.

(9) Unless the court finds that it is commercially unreasonable for this provision to apply, for the purposes of subsection (5), a secured party is deemed not to have an interest in an item of collateral that is destroyed or damaged if the obligation of the debtor as provided in the security agreement is fully secured by another or other items of collateral subject to a security interest that are not destroyed, damaged or with respect to which the cost of seizure of collateral is not disproportionate to the value of the collateral.

Application of this provision entails an assessment of the existing and potential value of the collateral that has not been damaged or destroyed and, consequently, is still available to the secured party. The factors that go into this determination will be the nature of the collateral and the way it is being or is likely to be used by the debtor. For example, a court would very likely conclude that this provision does not apply where the collateral is inventory which is to be sold by the debtor. In other circumstance a court may decide that it is commercially unreasonable to require the secured party to bear the risk of unexpected depreciation or loss of this collateral.

- (10) An action may be brought against any person who:
- (a) is in possession of collateral when it is destroyed;
 - (b) refuses to surrender possession of collateral upon reasonable request of the secured party who is entitled to seize it as provided in Part V;
 - (c) does anything with respect to the collateral that directly results in it being commercial unreasonable for the secured party to seize the collateral as provided in Part V;
 - (d) does anything with respect to the collateral that the person knows or could reasonably expect to know would result in:
 - (i) destruction of the collateral; or
 - (ii) it being commercially unreasonable for the secured party to seize the collateral as provided in Part V.

This provision gives a cause of action for recovery of damages in situations where it is commercially impossible or commercially unreasonable for the secured party to enforce a security interest through seizure and disposition of the collateral. Note that mere refusal on the part of the person in possession can be the basis for the action so long as a reasonable request for surrender of the collateral has been made by the secured party.

Provision 10(d) addresses the situation in which the defendant was not directly responsible for the destruction of the collateral and has not himself or herself refused to surrender it (because he or she no longer has possession of it). However, the defendant may still be liable to the secured party when he or she can reasonably expect that his or her actions in dealing with the collateral may ultimately result in its destruction or significantly interfering with the secured party's ability to seize it. An example of this would be one in which the defendant has sold the collateral to someone who could reasonably be expected to destroy it through use or take it out of the jurisdiction so as to make seizure commercial unrealistic.

(11) Unless otherwise provided in this section, the measure of damages recoverable in an action referred to in subsection (10) is the market value of the secured party's interest in the collateral as of the date the defendant obtained possession of the collateral less estimated costs of seizure and disposal had the secured party been able to seize and sell it in accordance with Part V.

This provision permits the secured party to recover the market value of the secured party's interest in the collateral as of the date the defendant obtained possession of it. This would allow recovery of not only the value of the collateral at the date of destruction or preclusion of the ability to seize it, but also any depreciation in value of the collateral when it was in the possession or under the control of the defendant.

(12) An action may be brought against a person who:

(a) is in possession of collateral when it is damaged; or

(b) takes any action with respect to the collateral that the person knows or who reasonably can be expected to know is likely to result in damage to the collateral; or

(c) takes any action with respect to the collateral that the person knows or can reasonably be expected to know will result in significant extra costs of seizure of the collateral in a manner provided in Part V.

This provision gives a secured party's right of action to recover damages reflected in depreciation of the collateral when it is in the possession of a defendant other than the debtor. It also provides for recovery of loss in value of the collateral or expended costs resulting from actions of the defendant in circumstances where he or she could reasonably expect that

the collateral will be damaged or that the extra costs will be incurred by the secured party in exercising its seizure rights under Part V of the *PPSA*.

(13) Unless otherwise provided in this section:

(a) the measure of damages recoverable in an action referred to in provision (12)(a) is the market value of the secured party's interest in the collateral as of the date the defendant obtained possession of the collateral less the market value of the secured party's interest in the collateral at the date of seizure by the secured party;

(b) the measure of damages recoverable in an action referred to in provision (12)(b) is the amount of the loss of value of the secured party's interest in the collateral that was reasonably foreseeable by the defendant; and

(c) the measure of damages recoverable in an action referred to in provision (12)(c) is the amount of extra seizure costs incurred by the secured party resulting from the actions of the defendant.

As a result of provision (13)(a), the secured party is entitled to the amount of loss in value of the collateral when in was in the possession of the defendant. This includes normal depreciation.

(14) No action may be brought under provision (12)(c) for recovery of costs against a subordinate secured party who gave written notice to the secured party prior to disposition of the collateral of its intention to enforce its security interest.

If a subordinate secured party has given notice to a secured party that has a prior security interest of its intention to enforce its security interest, the holder of the prior security interest can be expected to move immediately to enforce its security interest. If it does not, it cannot recover any extra seizure costs that result from the actions of the subordinate secured party in disposing of the collateral.

(15) No action may be brought to recover damage in the form of depreciation in the market value of the collateral against a transferee of collateral who:

- (a) did not have knowledge of the secured party's security interest in the collateral; and
- (b) could not have discovered the secured party's security interest in the collateral through a search of the applicable registry using the search criteria available to a person who requests a search of the registry.

The effect of this provision is to preclude a claim based on depreciation of the market value of the collateral in cases where the defendant did not know that it was subject to a security interest and could not have become aware of the security interest through a search of the registry. This would be the case where the defendant is a transferee who obtained his or her interest in non-serial numbered goods from someone other than the debtor. In these circumstances, a search of the registry using the only search criterion available to him or her would not have revealed the security interest.

(16) A court may award exemplary damages.

(17) The measure of damage recoverable under this section by a secured party shall be reduced to the extent:

- (a) that the secured party contributed to the loss or failed to take reasonable measures to minimize the loss;
- (b) of the amount of compensation recovered by a secured party as a result of insurance;
- (c) of the amount of compensation recovered by a secured party from a guarantor or indemnitor.

This provision requires reduction of the amount recoverable in cases where the secured party has contributed to the loss or when it has recovered from insurance or from a guarantor or indemnitor. There is no requirement that the secured party first seek recovery from these sources before bringing action against the defendant.

(18) Subject to provision (6), an action brought under this section shall be dismissed when the defendant tenders to the secured party an amount equal to the value of the secured party's interest in the collateral at the date the defendant obtained possession of it and the amount referred to in [PPSA] subclause 62(1)(a)(ii)¹⁰⁹ after subtracting amounts referred to in provisions (17)(b) and (c).

This provision reflects the right of the defendant to "buy out" the secured party's interest in the collateral by paying the value of the secured party's interest in the collateral at the date the defendant obtained possession of it plus the costs set payable when a debtor redeems collateral as provided in the PPSA.

(19) An action may be brought by a secured party to recover from a person who has a subordinate security interest in the collateral and who has seized and sold or collected the collateral from a person who is obligated pursuant to an intangible or chattel paper.

This provision gives to a secured party who has a security interest in liquid collateral (e.g., accounts) an action against a secured party who has a subordinate interest in the collateral and who has seized and sold or collected the collateral from an account debtor.

(20) A person who compensates a secured party whether pursuant to an order in an action brought under this section or otherwise is subrogated to the extent of the compensation to the rights of the secured party.

5. Conclusion

In its present form, the *Personal Property Security Act* provides for and regulates rights of secured creditors that are central to the proprietary nature of security interests. However, the Act does not deal with the rights and remedies of secured creditors where the collateral has been damaged or destroyed or where exercise of the statutory rights of seizure and sale are logistically impossible or commercially unrealistic. The accepted view is that these rights and remedies are provided by the common law through the traditional property torts.

¹⁰⁹ This provision of the *PPSA* requires payment of a sum equal to the reasonable expenses of seizing, repossessing, holding, repairing, processing and preparing the collateral for disposition, if those expenses have been incurred by the secured party, and any other reasonable expenses incurred by the secured party in enforcing the security agreement.

The author's examination of the property torts in the context of the rights of secured creditors leads to the conclusion that the common law does not provide an adequate structure within which the *in rem* rights of secured creditors are recognized. The common law property torts, with one possible exception, are both conceptually inappropriate and functionally ill-suited for this purpose. Conversion, the cause of action often described as the source of protection for property interests in personal property and the one most commonly used when the statutory rights of seizure and sale of collateral are not possible or commercially realistic, was not designed to provide a remedy for damage to or loss of the claimant's *in rem* interest in personal property. Its focus is on interference with the claimant's possession or right to possession, regardless of the quantum of interest held by the claimant in the converted property. Anomalously, a successful conversion action results in a damages award that assumes that the claimant is the "owner" of the converted property. The other property torts, with the possible exception of the action for damage to a reversionary interest, are either inadequate or inappropriate as measures to address loss or damage to collateral.

The inadequacy of the common law property torts in this context induced the author to conclude that statutory intervention is required. Statutory law dealing with damage to or loss of collateral should involve more than minor changes at the margins of the property torts. The incoherence and uncertainty endemic to this aspect of the common law dictates adoption of the *tabula rasa*, an approach that was used in the formulation of modern Canadian secured transaction law. The core of a new statutory system, which should be reflected in all of its features, should be the treatment of a security interest as a limited, accessory property interest in property of the debtor. The structure should also provide statutory recognition that there are circumstances in which it is contrary to good public policy to make a person liable for damage to a secured party's interest in collateral.

The author has set out in this article in statutory form a model for such a system that reflects the underlying principles and policies of the *Personal Property Security Act*. It has not been influenced in any significant way by the common law property torts.