

PPSA PROBLEMS: EXPLORING A PRIORITY HITCH BETWEEN CHATTEL PAPER PURCHASERS AND PURCHASE-MONEY SECURITY INTEREST PROCEEDS CLAIMANTS

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I. INTRODUCTION

It is crucial for a creditor, who takes a security interest in a debtor's property, to understand his or her priority ranking in relation to the collateral. Priority rules are among the most essential mechanisms of secured transactions statutes.¹ These rules resolve disputes between parties holding competing security interests.² They give creditors confidence in the enforceability of their transactions, allowing them to make informed decisions when advancing credit. Clear and comprehensible priority rules promote commercial development in accordance with the underlying values of personal property security law ("PPSL").³

While the *Personal Property Security Act* ("PPSA") aims to provide commercial parties with a comprehensive statutory framework that governs the "creation, perfection, priority

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¹ Richard McLaren, *Secured Transactions in Personal Property in Canada*, 3rd ed (Toronto: Carswell, 1989) at §7.00.

² Halsbury's Laws of Canada (online), *Personal Property Security Acts*, "Property: Movables: Secured Transactions" (VII.1(3)(b)) at HCF-230.

³ Clayton Bangsund, "PPSL Values" (2015) 57 CBLJ 185.



and enforcement of security interests in all types of personal property”,⁴ it is not without its limitations and uncertainties. For example, who has priority when a supplier of inventory is competing against a purchaser of chattel paper that is the proceeds of that very inventory? Current legislation should be scrutinized, and proposals for statutory reform should be carefully considered and implemented where necessary.⁵

The Canadian Conference on Personal Property Security Law (“CCPPSL”) published a report in 2017 proposing changes to the current PPSAs in all Canadian jurisdictions on matters that encompass “perceived omissions, troublesome court interpretations, wording ambiguities, the need to ensure that the Acts reflect recent changes in business practices and the growing importance of inter-jurisdictional financing transactions.”⁶ In light of this report and Bill 151,⁷ which has been passed by the Saskatchewan Legislature (pending Proclamation) to amend the *Personal Property Security Act*,⁸ it is important to highlight additional areas of potential ambiguity.

This paper examines a shortcoming in the current priority provisions of the SPPSA and offers a proposal for reform to address it. In Part II, I provide general background information on the relevant priority provisions of the SPPSA and how they apply to PPSL

⁴ Ronald C.C. Cuming, Catherine Walsh & Roderick J. Wood, *Personal Property Security Law*, 2nd ed (Toronto: Irwin Law, 2012) at 6.

⁵ Ronald C. C. Cuming et al, “Report to the Canadian Conference on Personal Property Security Law on Proposals for Changes to the Personal Property Security Acts” (Report delivered at the Canadian Conference on Personal Property Security Law, (21-23 June 2017)) at 1 [CCPPSL Report].

⁶ *Ibid.*

⁷ Bill 151, *An Act to amend The Personal Property Security Act, 1993 and to make consequential amendments to certain Acts*, 3rd session, 28th legislature, Saskatchewan, 2018 (third reading March 12, 2019).

⁸ SS 1993, c P-6.2 [SPPSA].

generally. Part III then sets out a scenario in which two secured parties claim priority to the same property. The scenario is analyzed under the current Saskatchewan legislative framework along with that of other Canadian jurisdictions, the United States, and finally the recommended framework proposed in the CCPPSL report. By analyzing the scenario under these various frameworks, I aim to show that there is potential for confusion and ambiguity in the current SPPSA and Bill 151. In Part IV, I combine the various interpretations and potential resolutions explored in Part III and recommend amendment to the current legislation and Bill 151. I offer some final remarks in Part V.

II. BACKGROUND INFORMATION ON PRIORITY PROVISIONS

Section 35 of the SPPSA sets out the general rule for resolving a priority dispute between competing security interests. However, the Act also contains more specific priority provisions relating to particular situations that are to be applied first, where applicable.⁹ The specific priority provisions analyzed in this paper pertain to protecting the interests of (i) transferees obtaining quasi-negotiable collateral as proceeds of inventory and (ii) purchase-money security interest (“PMSI”) holders. These priority provisions are outlined in sections 31 and 34 of the SPPSA.

⁹ CED 4th (online) *Secured Transactions in Personal Property*, “Proceeds from Collateral: Priority of Claims in Proceeds” (V.4) at §83.

In order to comprehend these provisions, some definitions must be understood. The quasi-negotiable collateral dealt with by this paper is chattel paper. “Chattel paper” is defined by the SPPSA as:

- one or more writings that evidence both a monetary obligation and:
 - (i) a security interest in, or lease of, specific goods; or
 - (ii) a security interest in, or lease of, specific goods and accessions.¹⁰

Chattel paper commonly takes the form of a conditional sales contract which allows the seller to retain an interest in the property as the buyer makes installment payments. The interest terminates when all installment payments have been paid by the buyer.

The priority provision dealing with purchasers of chattel paper is found in subsection 31(7) of the SPPSA:

A purchaser of chattel paper who takes possession of it in the ordinary course of the purchaser’s business and for new value has priority over any security interest in the chattel paper that:

- (a) was perfected pursuant to section 25, if the purchaser does not have knowledge at the time of taking possession that the chattel paper is subject to a security interest; or
- (b) has attached to proceeds of inventory pursuant to section 28, whatever the extent of the purchaser’s knowledge.¹¹

In order for a purchaser of chattel paper to gain priority over other security interests in the same chattel paper, she must take possession of the chattel paper in the ordinary course of business for new value.¹² Where the chattel paper is held by the secured party as original

¹⁰ SPPSA, s 2(1)(f).

¹¹ SPPSA, s 31(7).

¹² Note that this is effective only if there is a physical copy of the chattel paper. For further discussion of electronic chattel paper, see generally: Cory Kapeller, “Keeping Up with the Joneses: A Review, Critique and

collateral, the knowledge of the purchaser is important.¹³ However, if the chattel paper is classified as proceeds of an inventory sale, knowledge becomes irrelevant, and the purchaser will have priority to the chattel paper regardless of her knowledge of other security interests.¹⁴

Since the type of collateral is critical to this analysis, it is important to understand the meaning of “proceeds”. The Act defines “proceeds” to mean:

- (i) identifiable or traceable personal property, fixtures or crops:
 - (A) that are derived directly or indirectly from any dealing with collateral or the proceeds of collateral; and
 - (B) in which the debtor acquires an interest;
 - (ii) a right to an insurance payment or any other payment as indemnity or compensation for loss of or damage to the collateral or proceeds of the collateral;
 - (iii) a payment made in total or partial discharge or redemption of an intangible, chattel paper, an instrument or investment property; or
 - (iv) rights arising out of, or property collected on, or distributed on account of, collateral that is investment property;
- but does not include animals merely because they are the offspring of animals that are collateral.¹⁵

Another important concept for this analysis is the PMSI. The SPPSA defines a “purchase-money security interest” as:

- (i) a security interest taken in collateral, other than investment property, to the extent that it secures all or part of its purchase price;
- (ii) a security interest taken in collateral, other than investment property, by a person who gives value for the purpose of enabling the debtor to acquire rights in the collateral, to the extent that the value is applied to acquire those rights;
- (iii) the interest of a lessor of goods pursuant to a lease for a term of more than one year; or

Analysis of Electronic Chattel Paper Approaches and Proposals” (23 January 2019), online (pdf): *JuliusErwin* <JuliusErwin.com>.

¹³ SPPSA, ss 37(1)(a), 37(2). This provision outlines the circumstances in which a person or corporation is deemed to have knowledge.

¹⁴ SPPSA, s 31(7)(b).

¹⁵ SPPSA, s 2(1)(hh).

(iv) the interest of a consignor who delivers goods to a consignee pursuant to a commercial consignment; but does not include a transaction of sale and the lease back to the seller and, for the purposes of this clause, “purchase price” and “value” include credit charges and interest payable for the purchase or loan credit;¹⁶

Under the framework of the Act, a PMSI enables a debtor to acquire additional collateral by providing, to a party who finances the purchase of the collateral, priority over other creditors with security interests previously granted by the debtor.¹⁷ This “super-priority” over other creditors is provided by the priority rule in section 34 of the SPPSA. This paper specifically focuses on the super-priority granted by subsection 34(3), which deals with inventory. The provision is reproduced below:

a purchase-money security interest in inventory or its proceeds has priority over any other security interest in the same collateral given by the same debtor if:

- (a) the purchase-money security interest in the inventory is perfected at the time when the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier;
- (b) the secured party gives a notice to any other secured party who has, before the time of registration of the purchase-money security interest, registered a financing statement containing a description that includes the same item or kind of collateral; and
- (c) the notice mentioned in clause (b):
 - (i) states that the person giving the notice expects to acquire a purchase money security interest in inventory of the debtor and describes the inventory by item or kind; and
 - (ii) is given before the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier.¹⁸

¹⁶ SPPSA, s 2(1)(jj).

¹⁷ Halsbury’s Laws of Canada (online), *Potential Advantage from Purchase Money Security Interest*, “Priority Rules: Categories: By Type of Interest: The Purchase Money Security Interest: Advantages of Purchase Money Security Interests” (VIII.5(1)(b)) at HPS-606.

¹⁸ SPPSA, s 34(3). This provision is subject to s 34(6) which provides an exception for factors who purchase accounts, and s 28 which sets out the perfection methods for proceeds.

According to this provision, so long as the creditor ensures that his or her PMSI is perfected before the debtor obtains possession of the intended collateral and that notice is served on each party with a registration covering the collateral, the creditor will enjoy the super-priority provided by the SPPSA over all other secured creditors.

Both subsections 31(7) and 34(3) were created to deal with specific types of priority disputes. These provisions provide more certainty about priority competitions purchasers of chattel paper and PMSI holders, but this paper will outline why they are not fully comprehensive. The SPPSA, as currently in force, provides no guidance for determining who prevails in a priority dispute where the above provisions conflict. Thus, an analysis of the provisions as they are currently written, and engagement with principles of statutory interpretation, must be undertaken.

III. SCENARIO

To better understand the uncertainty that arises when subsections 31(7) and 34(3) of the SPPSA are both applicable to a priority dispute, it is useful to consider the following scenario, which will be considered under the SPPSA and various applicable PPSAs in other jurisdictions to analyze who has the superior priority claim to the personal property.

Imagine a Supplier provides vehicles to a Car Dealer as inventory. The Supplier takes all the required steps to perfect her security interest, establish PMSI status and secure super-priority in the vehicles under the applicable PPSA. Next, the Car Dealer sells a vehicle to a

Buyer under a conditional sales contract (“CSC”).¹⁹ After the sale, the Car Dealer decides he does not want to wait to receive full payment for the vehicle until the Buyer has paid all the installments, so he proceeds to sell the CSC to a Factor.²⁰ The Factor is in the business of purchasing CSCs, took possession of this particular CSC in the ordinary course, and provided Car Dealer full payment of the contract (at a discounted price) for the purchase of the CSC. Who has priority to the CSC between the Supplier and the Factor? In order to answer this question, an analysis of the legislation is required.

A. CANADA

1. RESULT UNDER THE CURRENT LEGISLATIVE FRAMEWORK

If we examine the above scenario under Canadian legislation, it is unclear which party has priority – impeding one of the essential values of PPSL.²¹ As noted earlier in this paper, where a specific priority rule exists, it is to be applied first. If no specific priority rule is applicable to the situation, then the general priority rule applies.

¹⁹ Under a conditional sales contract, a buyer takes possession of a purchased item but does not legally own it. The buyer makes installment payments on the item until all the payments are made at which time title is transmitted from seller to buyer. A conditional sales contract allows the seller to retain title of the property and repossess it if full payment is not made. See Bryan A. Garner, *Black’s Law Dictionary* (St. Paul: Thomson Reuters, 2014) *sub verbo* “retail installment contract.”

²⁰ A factor is a commercial agent. She is employed by another seller of property, in this case the Supplier, to sell property on the Supplier’s behalf. The factor takes possession of the property and is authorized by the seller to receive payment for that property from the buyer. See Garner, *ibid*, *sub verbo* “factor.”

²¹ See Bangsund, *supra* note 3 for a discussion of the PPSL values including clarity and certainty.



In Saskatchewan, the Car Dealer would be the debtor²² and the vehicles that the Supplier provided to the Car Dealer would be considered inventory, since they were being held for the purpose of selling to customers in the course of his car dealership business.²³ The Supplier's interest in the vehicles would be a PMSI under s. 2(1)(jj)(i) of the SPPSA. The CSC would serve as negotiable collateral and be classified as chattel paper under the Act.²⁴ Thus, both a purchaser of chattel paper interest and a PMSI holder interest would be present in this fact scenario.

The specific provision dealing with purchasers of chattel paper is subsection 31(7). Here, the Factor would qualify as a purchaser of chattel paper who took possession of the chattel paper in the ordinary course of his business for new value. More specifically, the interest would have attached to proceeds of inventory rendering the Factor's knowledge of any other security interests in the chattel paper irrelevant.²⁵ According to this provision, the Factor would enjoy priority over any other security interest in the chattel paper. Thus, the Factor's interest would have priority over the Supplier's interest.

However, this does not end the analysis. In this scenario, there is also a PMSI. The specific provision in the Act relating to PMSIs in inventory is found under subsection 34(3). Both the vehicles and their proceeds would be covered by this provision. According to the

²² Debtor is defined under s 2(1)(m)(i) of the SPPSA as a person who owes payment or performance of an obligation secured whether or not that person owns or has rights in the collateral.

²³ SPPSA, s 2(1)(x)(i). This determined is made at the time the Supplier's security interest attaches to the vehicles under SPPSA s 2(3).

²⁴ SPPSA, s 2(1)(f).

²⁵ SPPSA, s 31(7)(b).

scenario, the Supplier took all the required steps listed in SPPSA clauses 34(3)(a)-(c).²⁶ The Supplier would thus enjoy a super-priority over all other security interests in the vehicles given by the Car Dealer.²⁷ Therefore, under this provision the Supplier's PMSI would seem to have priority over the Factor's interest in the CSC – a result conflicting with the outcome under subsection 31(7).²⁸

There is no clear answer as to which of the contradictory methods of awarding priority under the two applicable specific priority rules should prevail. While this paper argues this contradiction yields no certain outcome, there are some opinions offered as to which method would prevail. Richard McLaren posits that provisions dealing with a purchaser of chattel paper will override the PMSI provisions.²⁹ This claim is based on the notion that the more specific provision for purchasers of chattel paper would override the more general PMSI provision. Although McLaren does not specifically state his underlying reasoning, he likely concludes the purchaser of chattel paper provision is more specific

²⁶ As outlined in the provision, the Supplier must give notice to any other secured party that has a financing statement containing a description that included the same item or kind of collateral to the vehicles before the Car Dealer took possession of the vehicles. The notice must state that the Supplier intends to acquire a PMSI in inventory.

²⁷ The security interest in the same collateral must be given by the same debtor in order for the super-priority to take effect under s 34(3) of the SPPSA.

²⁸ It is worth noting that s 34(6) of the SPPSA does not apply in these circumstances. Although it is a provision that deals both with PMSIs and factors, the exception only applies to accounts. An account is defined as follows:
a monetary obligation that is *not evidenced by chattel paper* or an instrument, whether or not it has been earned by performance, but does not include an investment property.

SPPSA, s 2(1)(b) [emphasis added].

Consequently, this exception allowing factors to take priority over PMSIs is not applicable to this scenario because the definition of accounts specifically carves out chattel paper.

²⁹ McLaren, *supra* note 1 at §7.02. McLaren references ss 28(3)(b) and 33(1) of Ontario's legislation (RSO 1990, c P10 [OPPSA]) to say s 33(1) is more specific. However, he goes on to say that Saskatchewan has parallel provisions in which the chattel paper purchaser provision still prevails.



because it includes the terms “chattel paper” and “proceeds of inventory.” This line of reasoning holds merit and will be further outlined in the interpretation of the provisions below; however, the issue is yet to be addressed by Canadian courts. As such, it is necessary to consider methods of interpretation of legislation.

2. RESOLVING THE PRIORITY CONFLICT

The application of standard principles of statutory interpretation supports the argument that the purchaser of chattel paper should enjoy priority over a prior PMSI in inventory in the same collateral given by the same debtor. In coming to this conclusion, this paper considers both the current framework for statutory interpretation as proposed by the Supreme Court of Canada and the Saskatchewan legislation on interpretation, along with the legislative purpose of the two provisions and other proposed statutory interpretation methods.

The law on statutory interpretation was summarized by the Supreme Court of Canada in *Krayzel Corp. v. Equitable Trust Co.*:

Statutory interpretation entails discerning Parliament’s intent by examining the words of a statute in their entire context and in their grammatical and ordinary sense in harmony with the statute’s schemes and objects...Throughout, it must be borne in mind that every statute is deemed remedial and is to be given “such fair, large, and liberal construction and interpretation as best ensures the attainment of its objects.”³⁰

³⁰ *Krayzel Corp. v. Equitable Trust Co.*, 2016 SCC 18 at para 15, [2016] 1 SCR 273. This approach has also been adopted in Saskatchewan. See e.g. *Canadian Union of Public Employees, Local 1486 v The Students’ Union of the University of Regina Student Inc.*, 2017 CarswellSask 280 at para 44 (SK LRB) [*Students’ Union*].



This summary is also supported by section 10 of Saskatchewan’s *The Interpretation Act* which provides that a “fair, large and liberal construction and interpretation that best ensure[s] the attainment of its objects” should be the correct starting point of interpreting legislation.³¹ Thus, applying the modern principles of interpretation requires assessment of the ordinary meaning of the words of a provision in the context of the SPPSA as a whole, keeping in mind the legislative purpose in enacting the particular provisions and Act, all while being done in a liberal fashion.³²

A consideration of the ordinary meaning of the words suggests awarding priority to the purchaser of chattel paper as proceeds of inventory. The words “has attached to proceeds of inventory” in their ordinary meaning would give the impression that the purchaser of the chattel paper would have priority in the outlined fact scenario since the chattel paper in question is proceeds of inventory. While a dictionary definition of proceeds refers to money obtained in a sale,³³ the Act contains a specific definition of proceeds (outlined in Part II) which prevails.³⁴ However, that does not end the analysis. Section 31(7) must be read in the context of the whole SPPSA and should be interpreted to give prominence to business efficacy.³⁵ A full reading of the SPPSA would result in the priority contradiction discussed above. In order to give a liberal interpretation that ensures the attainment of the objectives

³¹ *The Interpretation Act, 1995*, SS 1995, c I-11.2, s 10.

³² See *Students’ Union*, *supra* note 30 at para 47 for a summary of the applicable principles.

³³ Katherine Barber, *Canadian Oxford Dictionary* (Canada: Oxford University Press, 2004) *sub verbo* “proceeds”.

³⁴ Pierre-Andre Cote, Stephane Beaulac, & Mathieu Devinat, *The Interpretation of Legislation in Canada*, 4th ed (Toronto: Carswell, 2011) at 280.

³⁵ *Key National Leasing Ltd., Re*, 1989 CarswellOnt 147 at para 7 (Ont Sup Ct).

of the SPPSA, the legislative intent behind the provisions and underlying PPSL values must be examined.

Chattel paper plays an important role in facilitating secured transactions. It embodies the PPSL value of convenience by allowing a buyer or lessee “to arrange both the purchase or lease with the secured financing through the seller or lessor.”³⁶ This type of transaction plays a central role in financing automobiles and equipment in Canada.³⁷ By allowing the transfer of sales contracts to financing organizations at discounted values, it allows the sellers or lessors to maintain the finances required to continue running their businesses. If the financing organizations were not provided with a priority to these contracts under special PPSA rules, there could be a slowdown or cessation of these types of transactions.

In contrast, the purpose behind the PMSI super-priority in inventory is to ensure that a debtor is “always able to obtain credit from a new financier or supplier wishing to make additional purchases of property.”³⁸ This is grounded in the understanding that any prior secured party taking an interest in the debtor’s collateral did so satisfied with the collateral the debtor already possessed.³⁹ Thus, although another party may have taken an interest in the debtor’s property first, that interest is not diminished by allowing a PMSI holder to help the debtor acquire new property, since that property was never subject to the old interest. The PMSI then automatically attaches to the proceeds of the PMSI collateral due to the

³⁶ CCPPSL report, *supra* note 5 at 4.

³⁷ *Ibid.*

³⁸ McLaren, *supra* note 1 at §7.02.

³⁹ *Ibid.*

revolving nature of inventory.⁴⁰ Without automatic attachment, the PMSI holder would be required to keep detailed records as to how payments are made by the debtor, and this would be contrary to business efficacy.⁴¹

Comparing the purpose of the impugned priority provisions, from a business efficacy perspective, does not point to any definitive answers. Both provisions were intended to facilitate commercial efficiency by providing priority to certain creditors – but neither purpose provides an answer to which outcome would produce the most efficacy. As a result, it is necessary to consider other statutory interpretation principles. The common law statutory interpretation rule of *specialia generalibus derogant* states that “special words derogate from general words.”⁴² The PMSI priority provision in subsection 34(3) contains the word *proceeds*. Subsection 31(7) contains the words *chattel paper* and *proceeds of inventory*. Because subsection 31(7) contains a more specific descriptor of proceeds compared to the general descriptor in subsection 34(3), the purchaser of chattel paper provision in subsection 31(7) is the more specific provision.⁴³ With reference to the scenario laid out above, application of this principle results in the Factor receiving priority over the Supplier in accordance with subsection 31(7).

Although there is a strong argument that subsection 31(7) prevails over subsection 34(3), a contrary argument exists. Another interpretive principle dictates that provisions

⁴⁰ See SPPSA, section 28, which provides for automatic attachment of security interests in proceeds.

⁴¹ CCPSL report, *supra* note 5 at 19.

⁴² CED (online), *Statutes*, “Interpretation of Statutes: Common Law Rules: Ejusdem Generis Rule” (III.3(I)) at §150 [CED Ejusdem Generis Rule].

⁴³ CED (online), *Statutes*, “Interpretation of Statutes: Common Law Rules: Regard to Whole Statute” (III.3(i)) at §123.

appearing later in a statute should prevail over provisions that appear earlier. By applying this principle, subsection 34(3) would prevail, and the Supplier who maintained the PMSI has priority over the purchaser of chattel paper. While this principle has been applied throughout case law, research suggests that most cases applying this principle were interpreting contractual agreements opposed to legislation.⁴⁴ In addition, the later provisions were also the more specific provisions – the opposite of what is present in the SPPSA. Since we are not dealing with a contractual agreement, but instead with legislation in which the more specific provision appears first in the Act, it is unlikely that this principle will prevail over the principle of *specialia generalibus derogant* in resolving the priority conflict.

It is worth noting that other Canadian common law jurisdictions have PPSAs with parallel provisions to subsections 31(7) and 34(3) of the SPPSA that contain almost identical language.⁴⁵ All of these PPSAs have specific provisions dealing with priority for purchasers of chattel paper and PMSIs in inventory,⁴⁶ but do not contain any provisions that directly

⁴⁴ See e.g. *Hickman Equipment (1985) Ltd., Re*, 2003 NLSTD 22, [2003] NJ No 48 (the Newfoundland PPSA provisions later in the Act that were more specific to the dispute prevailed); *Ferguson v Canada (Treasury Board- Statistics Canada)*, 2009 PSLRB 21 at para 61 and *IBEW, Local 353 v BG High Voltage Systems Ltd.*, [2012] OLRD No 140 at para 45 (the later more specific provisions in the collective agreements were held to prevail).

⁴⁵ British Columbia – *Personal Property Security Act*, RSBC 1996, c 359 [BCPPSA]; Alberta – *Personal Property Security Act*, RSA 2000, c P-7 [APPSA]; Manitoba – *The Personal Property Security Act*, SM 1993, c 14 [MPPSA]; OPPSA, *supra* note 29; Prince Edward Island – *Personal Property Security Act*, SPEI 1997, c 33 [PPPSA]; Nova Scotia – *Personal Property Security Act*, SNS 1995-96, c 13 [NSPPSA]; Newfoundland and Labrador – *Personal Property Security Act*, SN 1998, c P-7.1 [NFPPSA]; Yukon – *Personal Property Security Act*, RSY 2002, c 169 [YPPSA]; Northwest Territories – *Personal Property Security Act*, SNWT 1994, c 8 [NWPPSA]; Nunavut – *Personal Property Security Act*, SNWT 1994, c 8 [NUPPSA].

⁴⁶ The following are the chattel paper purchaser and PMSI inventory provisions, respectively, in other Canadian jurisdictions: BCPPSA, ss 31(6), 34(2); APPSA, ss 31(6), 34(3); MPPSA, ss 31(7), 34(3); OPPSA, ss 28(3), 33(1); PPPSA, ss 31(6), 34(2); NSPPSA, ss 32(6), 35(2); NFPPSA, ss 32(6), 35(2); YPPSA, ss 30(5), 33(2); NWPPSA, ss 31(6), 34(3); NUPPSA, ss 31(6), 34(3).



state which priority rule should prevail. As a result, they all have the same priority contradiction with respect to the fact scenario outlined in this paper and do not offer further interpretive guidance to resolve the priority conflict. Given the above analysis of the applicable interpretation methods, the purchaser of chattel paper priority provision also would likely prevail over the PMSI provision in other jurisdictions.⁴⁷

B. UNITED STATES

The Uniform Commercial Code (“UCC”) in the United States of America helps to harmonize laws surrounding commercial transactions across all fifty states.⁴⁸ Article 9 of the UCC contains the laws relating to secured transactions. Section 9-330 contains a specific provision that deals with both a purchaser of chattel paper and PMSI:

(a) [Purchaser's priority: security interest claimed merely as proceeds.]

A **purchaser of chattel paper has priority** over a security interest in the chattel paper which is claimed merely as **proceeds of inventory** subject to a security interest if:

- (1) in good faith and in the ordinary course of the purchaser's business, the purchaser gives new value and takes possession of the chattel paper or obtains control of the chattel paper under Section 9-105; and
- (2) the chattel paper does not indicate that it has been assigned to an identified assignee other than the purchaser.....

(c) [Chattel paper purchaser's priority in proceeds.]

Except as otherwise provided in Section 9-327, a purchaser having priority in chattel paper under subsection (a) or (b) also has priority in proceeds of the chattel paper to the extent that:

- (1) Section 9-322 provides for priority in the proceeds; or
- (2) the proceeds consist of the specific goods covered by the chattel paper or cash proceeds of the specific goods, even if the purchaser's security interest in the proceeds is unperfected.....

(e) [Holder of purchase-money security interest gives new value.]

⁴⁷ BCPPSA, s 31(6); APPSA, s 31(6); MPPSA, s 31(7); OPPSA, s 28(3); PPPSA, s 31(6); NSPPSA, s 32(6); NFPPSA, s 32(6); YPPSA, s 30(5); NWPPSA, s 31(6); NUPPSA, s 31(6).

⁴⁸ “Articles of the UCC” online: *USLegal* <<https://uniformcommercialcode.uslegal.com/articles-of-the-ucc/>>.



For purposes of subsections (a) and (b), the **holder of a purchase-money security interest in inventory** gives new value for chattel paper constituting proceeds of the inventory.⁴⁹

This section is analogous to subsection 31(7) of the SPPSA as it outlines the special priority enjoyed by purchasers of chattel paper provided they give new value and make the purchase in the ordinary course of their business in good faith. However, there is a significant difference displayed in UCC §9-330(e) compared to subsection 31(7) of the SPPSA.⁵⁰ According to Official Comment 3 of the UCC, the holder of a previous PMSI in the chattel paper as proceeds of inventory is deemed to give new value.⁵¹ Thus, a PMSI holder is provided an opportunity to maintain her previous priority by qualifying under subsection (a) or (b), without making an additional advance against the chattel paper.

From the above, it appears that UCC §9-330 contemplated the contradiction that would occur when determining priority between a PMSI holder and a purchaser of chattel paper as proceeds of inventory. In anticipation of this conflict, the legislation specifically included the words “purchase-money security interest” within the purchaser of chattel paper provision for greater certainty.⁵² If we again return to the priority dispute scenario previous outlined in this paper, we can conceptualize how this difference affects the resulting priority. Under the UCC, the Supplier is deemed to give new value for the chattel paper constituting the proceeds of inventory. Thus, if she took steps to qualify under UCC §9-

⁴⁹ UCC §9-330 [emphasis added].

⁵⁰ Note that there are other significant differences between the UCC and the current SPPSA provisions, such as those dealing with electronic chattel paper. However, these differences are beyond the scope of this paper. See, generally, Kapeller, *supra* note 12 for a discussion on the differences regarding electronic chattel paper.

⁵¹ See UCC §9-330, Official Comment 3.

⁵² UCC §9-330(e).

330(a) by taking possession of the chattel paper in the ordinary course of business in good faith, she is deemed to have given new value and maintains priority to the chattel paper. However, if the Supplier did not take these steps (as is the case in the fact scenario outlined in this paper), the Factor who purchased the chattel paper would win in the priority dispute.

C. CCPSL REPORT PROPOSED AMENDMENTS

As stated earlier, the CCPSL report proposed a number of legislative changes to address ambiguities and interpretation issues in the current PPSAs of all Canadian jurisdictions. Below, I analyze some of the proposed amendments and how they would affect the fact scenario outlined in this paper to show that, notwithstanding the conflicting provisions, the legislative intent of subsections 31(7) and 34(3) is to give priority to purchasers of chattel paper as proceeds of inventory.

1. THE PROPOSED AMENDMENTS

Although there are no specific amendments or recommendations regarding the priority dispute between subsections 31(7) and 34(3), there are some suggested amendments that would affect this analysis. The CCPSL report proposes to remove the current subsection 31(7) and to replace it with two new subsections as follows:

~~(7) A purchaser of chattel paper who takes possession of it in the ordinary course of the purchaser's business and for new value has priority over any security interest in the chattel paper that:~~

~~(a) was perfected pursuant to section 25, if the purchaser does not have knowledge at the time of taking possession that the chattel paper is subject to a security interest; or~~

~~(b) has attached to proceeds of inventory pursuant to section 28, whatever the extent of the purchaser's knowledge.~~

(9) Subject to subsection (10), a purchaser of chattel paper who takes possession of the tangible chattel paper, or who obtains control of electronic chattel paper as provided in subsection 2(1.2), in the ordinary course of the purchaser's business and for new value, has priority over any security interest in the chattel paper if the chattel paper does not indicate that it has been assigned to an identified assignee other than the purchaser.

(10) When the rights arising under tangible chattel paper are transferred to a purchaser as electronic chattel paper and the tangible chattel paper is transferred to another purchaser who takes possession of it for new value and in the ordinary course of that purchaser's business, the interest of the purchaser of the tangible chattel paper has priority over the interest of the purchaser of the electronic chattel paper if the tangible chattel paper does not indicate that it has been assigned to an identified assignee other than the purchaser of the tangible chattel paper.⁵³

The new proposals are designed to provide a recognition of electronic chattel paper,⁵⁴ but they also address ancillary matters. By removing subsection 31(7) and replacing it with subsections 31(9)-(10), the proposed amendments remove the distinction between original collateral and proceeds, and instead focus on a "marking" system.⁵⁵ This amendment would prevent a chattel paper purchaser from acquiring chattel paper free from other security interests where the chattel paper has been "marked" or "stamped."⁵⁶ Thus, the proposed amendments provide an opportunity to prior secured parties, such as PMSI holders, to protect themselves by acquiring possession or control of the chattel paper (as also permitted under the current Act), or ensuring that the chattel paper is marked before the sale to a factor.⁵⁷

2. HOW THE CCPPSL REPORT AMENDMENTS APPLY

⁵³ CCPPSL report, *supra* note 5 at 14.

⁵⁴ *Ibid* at 15.

⁵⁵ *Ibid* at 16.

⁵⁶ *Ibid*.

⁵⁷ *Ibid*.

If the CCPPSL report amendments are applied to the fact scenario outlined in this paper to determine who has priority to the CSC between the Supplier and the Factor, they affect the previously determined outcome. In accordance with the interpretation methods outlined in Part III, the more general provision would not derogate from the specific provision. Of the proposed amendments, it is likely that subsections 31(9)-(10) would replace the old subsection 31(7) as the more specific provision dealing with purchasers of chattel paper as proceeds of inventory. However, proposed subsection (9) uses slightly different language than the current subsection (7). While subsection 31(7) specifically contains the words “proceeds of inventory”, the new subsection refers only to “any other security interest.” This broad term was likely meant to encompass more types of security interests in addition to dispensing with the need to distinguish between original collateral and proceeds, but it also removes the specificity found in the current provision. Regardless, subsection 31(9) would likely still be the more specific provision as “proceeds of inventory” falls within the meaning of “any security interest.”

If we consider the application of this proposed amendment to the fact scenario, the Factor would receive priority if he purchased the CSC free of markings. On the other hand, if the Supplier were to mark the CSC before the Factor purchased it, the Supplier would have priority.⁵⁸ This amendment does not include specific language that deems a PMSI holder to have given new value for the chattel paper in order to facilitate a new priority claim, as does

⁵⁸ Note that this provision is also applicable in determining priority between two factors. If one factor purchases and marks the chattel paper, but does not take possession of it, another factor cannot later purchase the same chattel paper, take possession, and claim priority.



UCC §9-330. However, it does provide an opportunity for PMSI holders to maintain their super-priority – a feat which is not possible under the current legislative framework.

IV. A SUGGESTED SOLUTION

After comparing and contrasting the various interpretations, jurisdictions, and the CCPPSL report, I propose an amendment that combines the CCPPSL report proposed amendments for section 31 of the SPPSA with the current UCC §9-330. I recommend replacing subsection 31(7) with the proposed addition of subsections 31(9)-(10) as suggested by the CCPPSL report. To remove further ambiguity, I suggest adding more specific language to subsection 31(9), similar to that in UCC §9-330(e). The proposed addition to subsection 31(9) would read as follows:

(9) Subject to subsection (10), a purchaser of chattel paper who takes possession of the tangible chattel paper, or who obtains control of electronic chattel paper as provided in subsection 2(1.2), in the ordinary course of the purchaser's business and for new value, has priority over any security interest in the chattel paper, **including a purchase-money security interest in the chattel paper as proceeds of inventory**, if the chattel paper does not indicate that it has been assigned to an identified assignee other than the purchaser.⁵⁹

This change would dispense with the need to determine the purchaser's knowledge and directly addresses the priority contradiction between PMSI holders and purchasers of chattel paper analyzed in this paper. The new language would make it clear that a purchaser of chattel paper as proceeds of inventory would triumph in a priority dispute over a holder

⁵⁹ This proposal is not completely novel, but instead adds language to the already-proposed amendment for s 31(9) set out in the CCPPSL report (*supra* note 5 at 14).

of a PMSI in that same chattel paper as proceeds of inventory, subject to the chattel paper being previously marked. However, there is a risk that the addition of the phrase “including a purchase-money security interest in the chattel paper as proceeds of inventory” could invoke the principle of *ejusdem generis*,⁶⁰ allowing only security interests similar to that of chattel paper as proceeds to be included in the definition of “any security interest”. Nevertheless, in my proposed amendment the general words come first, making it less likely that the principle of *ejusdem generis* would be applied.

The above suggestion is also consistent with the PPSL values of transparency, predictability, and certainty.⁶¹ It would allow creditors to be more confident in their business transactions and provide all parties with a more comprehensive set of rules for determining priorities. In addition, it would also be consistent with the legislative objective of facilitating the sale of chattel paper in order to finance vehicles and equipment. If this recommendation is implemented, resolution of the scenario would be straightforward – the Factor, who purchased the chattel paper as proceeds of inventory free of markings, would have priority despite the previous PMSI held by the Supplier in the chattel paper as proceeds of inventory.

V. CONCLUSION

The SPPSA should be amended to provide more clarity to subsections 31(7) and 34(3). Currently, these provisions do not adequately dictate who prevails in a priority

⁶⁰ This principle may apply when general words follow a list of particular items having a specific meaning. If general words follow the list, then the general words are “interpreted as being limited to all other persons or articles of a like class or nature.” See note 42.

⁶¹ Bangsund, *supra* note 3.

dispute between a PMSI holder and a purchaser of chattel paper as proceeds of inventory. The contradictory priority resolutions produced by subsections 31(7) and 34(3) are verified by analysis of the scenario set out in Part III. Left unchanged, the contradiction will persist, and future disputes will be decided through application of the interpretation methods outlined in this paper.

Adopting a combination of the proposed amendments set out in the CCPPSL report and the language used in the UCC would effectively eliminate the perceived shortcoming and provide future creditors with more certainty. The SPPSA should be amended to more clearly state that the purchaser of chattel paper takes priority over a PMSI holder in the same chattel paper as proceeds of inventory, subject to the PMSI holder marking the chattel paper. This is consistent with both UCC §9-330 and the CCPPSL report proposed amendments in that it affords the purchaser of chattel paper priority generally, but leaves open an opportunity for the PMSI holder to take additional steps to protect and uphold her priority. Amending the SPPSA as I suggest would benefit commercial parties by removing any lingering uncertainty about resolution of such priority disputes.

